

**STATE OF ILLINOIS**

**ILLINOIS COMMERCE COMMISSION**

Verizon North Inc. and Verizon	:	
South Inc.	:	
	:	
Verified Petition for Certification	:	02-0560
pursuant to 220 ILCS 5/13-517(a) or	:	
Waiver pursuant to 220 ILCS	:	
5/13-517(b).	:	

**ORDER**

DATED: June 24, 2003

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**ORDER**

By the Commission:

**I. BACKGROUND AND PROCEDURAL HISTORY**

On August 30, 2002, Verizon filed a Petition “for certification that Verizon meets the advanced services requirements of Section 13-517(a) of the Illinois Public Utilities Act (the ‘Act’), or in the alternative satisfies the requirements of Section 13-517(b) for a full waiver of such advanced services requirements.”

On October 2, 2002, Staff filed a Motion To Dismiss Without Prejudice For Failure To Give Proper Notice Or, In The Alternative, To Compel Proper Notice And Extend Schedule (“Motion to Give Proper Notice”). Staff’s Motion to Give Proper Notice contended that Section 13-517 required Verizon to give direct notice of this proceeding to potentially affected customers instead of publication notice. Pursuant to an agreement among the parties, Verizon agreed to provide actual notice to its customers. To allow for the giving of such notice, the 180-day time period for the Commission to take action in this proceeding pursuant to Section 13-517 of the Public Utilities Act was extended by agreement to May 27, 2003. In addition, Verizon stated its opinion that the 180 day time period was not jurisdictional and that the passage of that time period would not divest the Commission of jurisdiction over this matter. Direct notice of this proceeding was provided to all Verizon customers through a bill insert.

Evidentiary hearings in this proceeding were held in Springfield, Illinois, on January 28, 29, and 30, 2003, and March 10, 2003. A Briefing Schedule was established and a Proposed Order was served on the parties on April 28, 2003. A schedule was established calling for Briefs on Exceptions to be filed by May 5, 2003 and Reply Briefs on Exceptions to be filed by May 8, 2003. A Joint Motion was filed seeking an extension of the filing dates and proposing that the date for Commission action be extended to June 30, 2003, which is 6 months from the date all Petitions to Intervene were to have been filed in this matter. The motion was granted. Briefs on Exceptions and Replies as received have been duly considered in reaching the conclusions herein.

## II. SECTION 13-517 OF THE PUBLIC UTILITIES ACT

Section 13-517 of the Act provides as follows:

(a) Every Incumbent Local Exchange Carrier (telecommunications carrier that offers or provides a noncompetitive telecommunications service) shall offer or provide advanced telecommunications services to not less than 80% of its customers by January 1, 2005.

(b) The Commission is authorized to grant a full or partial waiver of the requirements of this Section upon verified petition of any Incumbent Local Exchange Carrier ("ILEC") which demonstrates that full compliance with the requirements of this Section would be unduly economically burdensome or technically infeasible or otherwise impractical in exchanges with low population density. Notice of any such petition must be given to all potentially affected customers. If no potentially affected customer requests the opportunity for a hearing on the waiver petition, the Commission may, in its discretion, allow the waiver request to take effect without hearing. The Commission shall grant such petition to the extent that, and for such duration as, the Commission determines that such waiver:

(1) is necessary:

(A) to avoid a significant adverse economic impact on users of telecommunications services generally;

(B) to avoid imposing a requirement that is unduly economically burdensome;

(C) to avoid imposing a requirement that is technically infeasible; or

(D) to avoid imposing a requirement that is otherwise impractical to implement in exchanges with low population density; and

(2) is consistent with the public interest, convenience, and necessity.

The Commission shall act upon any petition filed under this subsection within 180 days after receiving such petition. The Commission may by rule establish standards for granting any waiver of the requirements of this Section. The Commission may, upon complaint

or on its own motion, hold a hearing to reconsider its grant of a waiver in whole or in part. In the event that the Commission, following hearing, determines that the affected ILEC no longer meets the requirements of item (2) of this subsection, the Commission shall by order rescind such waiver, in whole or in part. In the event and to the degree the Commission rescinds such waiver, the Commission shall establish an implementation schedule for compliance with the requirements of this Section.

(c) As used in this Section, "advanced telecommunications services" means services capable of supporting, in at least one direction, a speed in excess of 200 kilobits per second (kbps) to the network demarcation point at the subscriber's premises.

220 ILCS 5/13-517.

### **III. POSITION OF THE PARTIES**

#### **A. Verizon's Position**

##### **1. Verizon Meets Section 13-517(a)**

Verizon begins this argument by asserting that the language in Section 13-517 is clear and unambiguous:

(a) Every Incumbent Local Exchange Carrier (telecommunications carrier that offers or provides a noncompetitive telecommunications service) shall offer or provide advanced telecommunications services to not less than 80% of its customers by January 1, 2005.

c) As used in this Section, "advanced telecommunications services" means services capable of supporting, in at least one direction, a speed in excess of 200 kilo-bits per second (kbps) to the network demarcation point at the subscriber's premises.

220 ILCS 5/13-517.

According to Verizon the record clearly demonstrates that Verizon's current intrastate advanced telecommunications services offerings meet the Act's requirements. Verizon asserts that it currently offers several intrastate products that satisfy the Act's definition of "Advanced Telecommunications Services" and at least one of these services is available to all Verizon customers today. Verizon's DS-1 service provides data speeds of 1.544 million bits per second ("Mbps") in both directions. DS-1 service can be provisioned to virtually all customers on demand utilizing copper loops with HDSL technology or with fiber when available. Verizon's Frame Relay ("FR") service is a "fast packet" service that permits the transmission of data at speeds from 56 kbps up

to 1.544 megabits per second. Verizon's Asynchronous Transport Mode Service ("ATM") also is a "fast packet" service that permits flexible data speeds up to and beyond 45 Mbps. Verizon also offers High Capacity Digital ("HCD") Services that provide dedicated, point-to-point digital transport capabilities between two customer designated locations. Verizon witness White provided a detailed explanation of each of these services in his Direct Testimony. Verizon contends that no party disputed the fact that these services constitute advanced telecommunications services as defined in the Act.

Verizon requests certification because unless a waiver is granted, Section 13-517 of the Act will require it to offer or provide advanced telecommunications services to not less than 80% of its customers by January 1, 2005. 220 ILCS 5/13-517. Without certification, Verizon could find itself in violation of Section 13-517 by that date, because of the significant amount of planning and investment necessary to meet the requirements of Section 13-517.

## **2. Verizon Seeks a Waiver Pursuant To Section 13-517(b)**

Verizon alternatively seeks a waiver pursuant to Section 13-517(b) of the Act. Verizon asserts that it does not have an intrastate offering, aside from those subject to the certification request, which qualifies as an advanced telecommunications service under the Act. Verizon witness Trimble indicated that Verizon did support one service (Infospeed Digital Subscriber Line ("DSL" or "DSL TS" for digital subscriber line transport service)) that qualified as an advanced telecommunications service but argued that DSL is an interstate "advanced service," the nature of which would be explained by Verizon witness Mr. White. Mr. Trimble went on to argue that Verizon's DSL offerings are entirely regulated by the Federal Communications Commission ("FCC") (See Tariff F.C.C. No. 20, Section 5 - Part III) and that the Commission is preempted from ordering that DSL TS be deployed to satisfy the legislative mandate. Verizon goes on to note that the General Assembly did not define DSL TS as the measure to accomplish the mandate.

Notwithstanding the issue of jurisdiction, which Verizon indicated it was unwilling to waive, Verizon argues that the record demonstrates that DSL TS cannot be deployed without undue economic burden in the additional areas beyond where Verizon has already deployed the service. Verizon currently deploys and is in the process of deploying DSL TS in 37 of its 413 exchanges. Verizon is seeking a full waiver with respect to the Waiver Areas—the 376 exchanges where it has not currently deployed DSL TS.

Verizon further asserts that the record demonstrates that: the Waiver Areas are largely rural; the high cost of deploying DSL TS is not economically justified in light of the low penetration rates that Verizon has experienced in areas where it already is deployed; and a forced deployment in the Waiver Areas will result in significant revenue shortfalls and substantial subsidies and would be impractical and unduly economically burdensome, not only to Verizon but to Verizon's customer base as well.

Verizon goes on to assert that the record demonstrates that other competitors are currently providing advanced services in the Waiver Areas. For example, Intervenor the Village of Mt. Zion ("Mt. Zion") opposed Verizon's proposed waiver, but its witness, Paul Ruff, acknowledged that cable modem services are deployed and readily available to the citizens of Mt. Zion. The fact that competition for advanced services exists, and according to Verizon, will undoubtedly increase, further supports the fact that subsidized DSL TS is not the answer for these areas.

Finally, Verizon supports its waiver request through the proffer of a Bonafide Request Process ("BFR") for the Waiver Areas. Under this proposal, "interest-groups," including community groups, in the Waiver Areas can request a specific analysis of the financial requirements for deploying DSL TS facilities in a designated service area where current estimated market conditions do not warrant deployment of such facilities. This process allows Verizon and the interest group to engage in analyses, which could lead to rational DSL TS deployment in high-cost market areas. In short, this process will accommodate what the market actually desires, not what various groups believe the public wants, and will ensure there is no undue economic burden on Verizon and its customers.

Verizon asserts that it has provided clear and convincing evidence demonstrating that even under the most optimistic of conditions, deployment of DSL TS in the Waiver Areas will result in significant revenue shortfalls. One of the primary drivers is the lack of demand for these services. A recent survey performed by the Office of Economic and Regional Development, Southern Illinois University ("SIU") ("Rural Illinois High Speed Connectivity Technology Development Study – Final Report", June 2002) concluded that only 2% of the respondents that did not currently have high-speed access said they would be willing to pay \$50 per month to obtain such access. According to Verizon this low demand is confirmed by Verizon's actual penetration rates in Illinois. For areas in Illinois where DSL TS has been deployed for three or more years, the penetration rate is much less than the illustrative 17% penetration rate that Verizon utilized in its direct case to show that deployment of this service will not be profitable.

This lack of demand is further confirmed by the fact that even though notice of this proceeding was sent to every Verizon customer in Illinois, only two "customers" intervened. One of these intervenors, Mt. Zion, acknowledged that its citizens already have advanced services readily available to them in the form of cable modem service. According to Verizon, the fact that only one other individual came forward is a clear confirmation of the fact that there is no strong demand for these services. Without sufficient demand, DSL TS deployment cannot be a prudent investment. Verizon argues that if the investment is not prudent, by law, it cannot be mandated according to the terms of 220 ILCS 5/13-103, wherein the General Assembly codified its intent to encourage the provision of advanced telecommunications services to a high percentage of end users in the state, but recognized that the investment must be prudent. According to Verizon, the General Assembly's policy with respect to investment in

advanced telecommunications services could not be more clear than it is in Section 13-103 of the Act, which provides in pertinent part:

Sec. 13-103. Policy. Consistent with its findings, the General Assembly declares that it is the policy of the State of Illinois that:

...

(f) development of and *prudent investment in advanced telecommunications services* and networks that foster economic development of the State should be encouraged through the implementation and enforcement of *policies that promote effective and sustained competition* in all telecommunications service markets. 220 ILCS 5/13-103 (emphasis added). In the instant case, the record overwhelmingly demonstrates that investment in the Waiver Areas is not prudent.

Verizon argues that, when read together, Sections 13-103 and 13-517 reflect the General Assembly's recognition that the provision of advanced telecommunications services is not prudent in all areas. Accordingly, Section 13-517 contains a waiver provision that provides as follows:

The Commission shall grant such petition to the extent that, and for such duration as, the Commission determines that such waiver:

- (1) is necessary:
  - (A) to avoid a significant adverse economic impact on users of telecommunications services generally;
  - (B) to avoid imposing a requirement that is unduly economically burdensome;
  - (C) to avoid imposing a requirement that is technically infeasible; or
  - (D) to avoid imposing a requirement that is otherwise impractical to implement in exchanges with low population density; and
- (2) is consistent with the public interest, convenience, and necessity.

220 ILCS 5/13-517.

Verizon asserts that it meets the requirements for a full waiver with respect to the Waiver Areas. Verizon's waiver request is consistent with Section 13-517(b), which explicitly authorizes the Commission to grant a "full or partial waiver" of the requirements of Section 13-517. 220 ILCS 5/13-517(b). Section 13-517 further

provides that “...(t)he Commission shall grant such petition *to the extent that, and for such duration* as, the Commission determines that such waiver is necessary . . . .” 220 ILCS 5/13-517 (emphasis added).

As described by Verizon witness Trimble, Verizon’s Illinois service territory has 413 local exchanges serving approximately 860,000 access lines across approximately 20,000 square miles of operating territory. The vast majority of these exchanges serve rural areas, characterized by low customer densities. The average number of switched lines per square mile is approximately 40 lines within Verizon’s territory. Verizon’s Illinois switches, on average, handle fewer than 2,000 lines per switch, with approximately 62% of Verizon’s switches handling less than 1,000 switched access lines each.

The record demonstrates that the number of lines in a serving area, as well as the density of that serving area, play a major role in the resulting average cost to serve that area. As such, the size of the switching entity and density of the area served are major factors in determining the cost to upgrade an area for DSL capabilities. The record demonstrates that the costs Verizon will incur to deploy DSL TS in its rural areas will be significantly higher, on an average cost per qualified line basis, than the costs a more urban company, like Ameritech, would incur. Assuming similar rates for advanced telecommunication service between rural and urban customers, Verizon’s capability to recover any potential investment costs in rural areas is extremely diminished.

Verizon witnesses Slagle and White provided detailed support for Verizon’s facility-related cost estimates for deployment of DSL capabilities in an additional 376 exchanges in Illinois, which is what is required in order to allow Verizon to offer a DSL TS that could reach 80% of the company’s customer base. In regard to the costs estimates relied upon by Verizon, Verizon asserts that the costs are conservative estimates because they do not incorporate loop conditioning costs, which would likely be incurred in deploying DSL service in Verizon highly rural network. Further, the cost estimates do not include any additional costs that an ISP might incur to facilitate the provision of an end-to-end broadband service (the costs are only for Verizon’s regulated network requirements).

The record further demonstrates that to support the estimated capital expenditure, Verizon would need to generate substantial additional revenues each year. The incremental revenue estimates provided by Verizon do not include any contributions to cover the Company’s common costs, but are limited to “return of” (*i.e.*, depreciation) and “return on” (*i.e.*, rate of return) the capital invested plus coverage of various operating expenses (*e.g.*, tax; maintenance and repair; billing and collection; and sales expenses). According to Verizon, in determining the necessary revenues to recover costs, the record, again, demonstrates that Verizon utilized a very low annual charge factor (“ACF”) to develop a conservative (*i.e.*, low) estimation of required revenues.

According to Verizon, its revenues estimates assume an overly optimistic level of demand (17% take rate). Mr. Trimble's revenue estimate assumed an aggressive penetration rate of 17% of all qualified lines that terminate at residential households or business establishments as opposed to the actual market take rate currently experienced by Verizon. Even with this overly optimistic take rate, over a five-year period Verizon would under recover costs by more than \$200 million.

Verizon argues that the record demonstrates clearly that a 17% penetration rate would be an unrealistic number to achieve in 2007 for a number of reasons. First, in areas where DSL TS is currently deployed, Verizon is not even close to achieving a 17% penetration rate. The actual rate is much less than the 17% take rate utilized in Verizon's revenue estimates. Throughout his direct, rebuttal and surrebuttal testimonies, Verizon witness Trimble repeatedly stated that the demand penetration estimates that he employed in the financial analysis were "extremely aggressive" in order to "...avoid any contentious debate regarding the appropriate level of demand penetration." Verizon asserts that even under the best case revenue scenario utilized in its case, the data demonstrates that mandated deployment of DSL TS capabilities to comply with Section 13-517 would be unduly economically burdensome.

Verizon further observes that the actual take rate is supported by the results of consumer surveys of rural Illinois customers performed by SIU. The SIU study documented that about only 50% of residential customers have a computer at home. The study also concluded that 72% of the business establishments have a computer, but given that businesses (on average) have more than one telephone line, only 50% of Verizon's lines terminate to households or business establishments with a computer. Significantly, the survey concluded that only 2% of non-broadband customers would be willing to pay \$50 per month to obtain such access. The 2% found in the SIU study makes up a majority of the end-users in Verizon's rural serving areas (e.g., consumers without high-speed access). No party disputed the findings of this study, which were incorporated in Mr. Trimble's Direct Testimony.

Verizon witness Trimble testified that based upon his projections, the revenue levels that he would expect to be generated would be far short of the amount that would be necessary before even minimal costs are recovered. Mr. Trimble concluded that the necessary investments could not be found to be prudent because there is no reasonable expectation that a sufficient level of revenue generation could be achieved to support the deployment of DSL to 80% of Verizon's customers.

## **B AG's Position**

The People of the State of Illinois, by Attorney General Lisa Madigan, ("the People" or the "AG") recommend that the Illinois Commerce Commission ("Commission") find that Verizon has not met the 80% standard in section 13-517 because the advanced services upon which it relies for compliance are not reasonably available to 80% of its customers. Further, the People request that the Commission deny Verizon's waiver request because Verizon has not made a clear and specific

request for relief nor has it demonstrated that the requested relief is necessary or appropriate under the statute. Instead, according to the AG, Verizon has provided a vague and shifting waiver request and has provided unclear, incomplete and inconsistent supporting evidence.

Although the People believe the data presented by Verizon are flawed and are legally insufficient to support its request, the People contend that even Verizon's own data demonstrates that no waiver is necessary for the 69.9% of Verizon's customers who can currently receive DSL service from their central office without outside plant investment. Therefore, the Commission should, at a minimum, find that no waiver is necessary for these customers and require Verizon to deploy DSL accordingly.

## **1. Facts**

The AG begins by noting a number of undisputed facts. Verizon is a telecommunications carrier pursuant to Section 13-202, and is an ILEC under Section 13-517(a) of the Illinois Public Utilities Act. 220 ILCS 5/13-202 and 13-517. Verizon provides telecommunications service to approximately 745,000 business and residential customers in its service territory in Illinois. In addition to plain old telephone service ("POTS"), Verizon offers several data transmission services, including ATM, Frame Relay ("FR") and DS-1/DS-3 and Digital Subscriber Line (DSL) service, that meet the technical description of "advanced services" contained in 220 ILCS 5/13-517(c)

Verizon charges consumers \$395.00 in nonrecurring charges and \$285.00 in recurring monthly charges for FR, the least expensive of the non-DSL services. DS1 FR (port and access) services are tariffed at \$595.00 in nonrecurring charges and \$530.00 in recurring monthly charges. Verizon charges even more for ATM services, \$650.00 in nonrecurring charges, \$650.00 in recurring monthly charges, plus an additional charge ranging from \$63.00 to \$1,305. By contrast, Verizon stated that the per customer charge for DSL transport to an ISP is \$40.00, and that it expected ISPs to charge consumers about \$50.00 for the service. There is also a non-recurring charge of \$99.00 for DSL transport.

Verizon can provide DSL service to telephone customers connected to a central office by copper wires under a certain length (up to 18,000 feet) without investment in outside plant. Providing DSL to customers located farther from their central office requires substantially more expensive outside plant investment.

## **2. Argument**

According to the AG, Verizon must demonstrate that deployment of advanced services in its service area implicates one of the criteria listed in Section 13-517(b) and that a waiver is consistent with the public interest. A petition under Section 13-517(b) is governed by the Commission's Rules of Practice. Rule 200.100(c) states that pleadings before the Commission must include the specific relief requested. In order to comply with this rule, Verizon's application must specifically describe the waiver it is requesting

and provide appropriate supporting testimony and exhibits. In the opinion of the AG, neither Verizon's pleadings nor proofs meet the requisite standards.

Verizon has suggested that the availability of high speed advanced services, at prices that range from \$395.00 to \$650.00 in nonrecurring charges and \$285.00 to \$650.00 in recurring monthly charges, satisfies its obligation to provide advanced services to 80% of its customers. The People argue that services priced at those levels cannot be considered to be "offered" to 80% of Verizon's customers. Given the fact that Verizon North's residential consumers pay \$15.99 or \$16.99 plus usage charges that are less than five cents per call or per minute, and that DSL service could be made available for about \$50.00 per month, is the AG argues that it would be unreasonable for the Commission to conclude that a service priced at close to \$300.00 per month satisfies the statutory obligation to ubiquitously provide advanced services.

The People note that, in discussing House Bill 2900, which included section 13-517, its sponsor Senator Sullivan stated that "we call for the deployment of advanced telecommunications services to the point of eighty percent of service areas by January 1st, 2005. We want high technology to come to Illinois, and we want it to come here now." 92<sup>nd</sup> General Assembly, Senate Transcript, May 30, 2001, page 33. Senator Sullivan was clearly concerned about ubiquitous deployment of advanced services and about their availability to a large portion of Illinois consumers, and section 13-517 incorporates that concern. High speed advanced services, which address the needs of larger businesses are priced accordingly, and do not provide the kind of ubiquitous service section 13-517 addresses, particularly when technology exists to provide advanced services to residential and small business customers at a fraction of the cost associated with FR and ATM services. Further, according to the AG, section 13-517 would be meaningless if those business services, which were already available when section 13-517 was enacted and are effectively unusable to residential and small business consumers, were deemed sufficient to meet the requirements of the statute.

The AG goes on to asserts that Verizon failed to meet its burden to (1) define the scope of the waiver it is requesting and (2) support its request with relevant, comprehensive and credible evidence. From this, the AG concludes that Verizon's waiver request is too vague to evaluate and the information Verizon provided in support of its petition is both incomplete and insufficient to establish that a waiver is necessary and argues that Verizon's failure to meet its burden of proof warrants a denial of its application for a waiver.

The AG first notes that the relief that Verizon is seeking has changed several times throughout the course of this proceeding. First, in its Petition, Verizon sought a full waiver of its statutory obligation under Section 13-517 to provide advanced telecommunications services to 80% of its customers. The Petition set out the costs that Verizon believed it would incur if it is required to meet Section 13-517(a)'s 80% requirement, and asserted that the demand for DSL services is too low and will not support the cost, to make such services available to 80% of Verizon's customers.

Next, in its Direct Testimony, Verizon presented estimated costs to deploy DSL to reach 80% of its customers in each exchange and revenues expected from such deployment. These cost estimates were based on providing DSL to 80% of the customers in each of 376 out of Verizon's 413 exchanges. Verizon excluded costs associated with 37 exchanges in which there already existed or Verizon planned to deploy DSL. However, Verizon did not identify which exchanges were excluded, how many customers were being provided DSL in those exchanges, or how many more customers would be served under its analysis to reach the 80% per exchange threshold. Verizon determined the revenues associated with these costs by calculating 80% of the aggregate unserved lines, and applying a \$40 per line charge.

Verizon's Direct Testimony requested a waiver from the section 13-517 requirements to the extent the ICC interprets the law to mandate DSL. Verizon did not describe the extent or duration of its requested waiver and did not specifically identify the areas where DSL was already available other than to say it included 49 central offices, or 37 exchanges. The AG asserts that it is impossible to determine how many or what percentage of customers Verizon was willing to serve or was currently serving, or what costs and revenues were associated with those customers. Based on Verizon's testimony, which it claims, "demonstrated what it would cost to ubiquitously deploy DSL transport services to 80% of its customers," it appeared that Verizon was seeking a waiver for its entire service area.

In Rebuttal Testimony, Verizon continued to refer to the relief it was requesting as a "full waiver." However, in its Surrebuttal Testimony, Verizon's definition of "full waiver" changed yet again to include only consideration of deployment for lines that were not expected to be DSL-qualified by year-end 2002. Verizon explained its new position by stating that the "request for a full waiver covers the incremental lines that would need to be equipped for DSL transport capabilities to satisfy the overall requirements of Section 13-517." Ver. Ex. 7.0 at 5. Verizon dismissed the difference between its new "full waiver definition" and a partial waiver as a matter of semantics. Verizon again did not include the location or identity of the lines where DSL was already provided or planned, nor did it state the number of lines or percentage of customers served.

According to the AG, Verizon's waiver request was further muddled during the evidentiary portion of this docket when Mr. Slagle testified that he believed Verizon was seeking a waiver for the "entire Illinois service territory," (Tr. 122), while Mr. Trimble said the waiver "is really a waiver in those places where we currently don't provide DSL services. The analysis we provided was for revenues in those incremental areas. It was also for capital in those incremental places." Tr. 423. Later in the hearing Mr. Trimble defined the waiver area as all exchanges other than the 37 in which DSL is offered or planned. Tr. 434. The ALJ requested information on whether the exchanges in which DSL had been deployed served 80% of the customers, and "the percentage of total customers overall" served by those exchanges. Tr. 432. People-Trimble Cross Ex. 3P shows the number of DSL qualified lines and the number of total lines in the 49

central offices, but according to the AG the overall percentage of DSL qualified lines to total lines has never been specifically provided by Verizon.

The AG goes on to assert that Verizon also failed to specifically address the effect of its request on the “public interest, convenience and necessity, as required by” 220 ILCS 5/13-517(b)(2). Based upon the assumption that by adopting section 13-517, the General Assembly concluded that there is a public interest in having advanced telecommunications services available ubiquitously throughout Illinois, the AG concludes that Verizon did not address how depriving some Illinois consumers of these services is consistent with the public interest, convenience and necessity even in instances where provision of these services would be profitable to the company.

The AG asserts that Verizon’s chameleon-like presentation has hampered the People, Staff and other parties’ ability to respond to Verizon’s waiver request. Section 13-517(b) authorizes the Commission to grant a waiver to the extent and duration that an ILEC demonstrates that it meets the waiver criteria. Verizon has not made such a demonstration. It originally requested a “full waiver,” but offered evidence addressing only some exchanges. It then recast its waiver request to cover all lines that “were not expected to be DSL qualified by year-end 2002.” Ver. Ex. 7.0 at 5. At the hearing, it presented a third waiver request, encompassing exchanges where DSL was unavailable to any lines. Further, each of these three requests was presented in general terms, the specific exchanges included or excluded were not identified and the data presented were far from consistent with any of these requests. Consequently, the AG urges the Commission to deny Verizon’s waiver request on the grounds that neither the Commission nor the interveners have had adequate notice of Verizon’s requested relief, and even at the point Initial Briefs were filed did not have a clear, specific and consistent description of Verizon’s waiver request. Further, the failure to provide complete information about the scope or duration of a possible waiver, or any discussion of how the public will benefit from a waiver, has prevented the Commission from determining the effect of the requested waiver, and whether the waiver would be consistent with the public interest, convenience and necessity, as required by section 13-517(b)(2).

In addition to the perceived deficiencies in Verizon’s request for relief, the AG goes on to assert that the cost and revenue projections Verizon provided to demonstrate the necessity of a waiver improperly include only “incremental” data and contain numerous inconsistencies and errors. When Verizon filed its waiver request with the Commission, it also filed testimony describing its network facilities and why a waiver would be appropriate. Verizon’s direct and subsequent testimony included only “incremental” cost and revenue projections, and excluded costs and revenue for existing deployment of advanced services done over the past four years. Verizon claimed in its Surrebuttal Testimony that because its waiver request was for incremental areas only, the costs of and revenues from existing DSL deployment were irrelevant and that it need only provide incremental, not total, cost and revenue information.

According to the AG, Verizon’s production of partial, incremental data renders the Commission unable to fairly and accurately evaluate the necessity of whatever waiver

Verizon is requesting. Section 13-517 requires deployment of advanced services to 80% of an ILEC's customers. However, Verizon did not provide information about the total costs and revenues related to 80% deployment. The fact that Verizon omitted cost and revenue data for existing DSL deployment does not mean that it is not relevant, or even crucial to, the Commission's decision in this docket. Instead, it means that Verizon chose not to provide information necessary for the Commission to effectively evaluate its waiver request.

Incremental information alone cannot be used to evaluate the existence of an economic burden. Section 13-517 requires ILECs to deploy advanced services to 80% of their customers by January 1, 2005 unless a waiver is necessary to avoid a significant adverse economic impact or an undue economic burden. 220 ILCS 5/13-517(a) & (b). Instead of providing data relevant to the statutory requirement, Verizon only provided what it characterized as incremental cost and revenue projections related to deployment of additional DSL service beyond what Verizon has already deployed. Even if this incremental cost and revenue information accurately presented the costs and revenues associated with a defined waiver area, it provides an insufficient basis for evaluating Verizon's waiver request. The information Verizon provided fails to accurately describe the real profitability of DSL service by excluding costs attributable to profitable current deployment areas and by excluding revenues from those same profitable areas. These exclusions distort the data and preclude a fair and comprehensive analysis of the cost to provide advanced services to 80% of Verizon's customers.

By excluding cost and revenue information on areas where DSL is currently deployed, Verizon is providing only a partial universe of information for the Commission to consider when determining the impact of different levels of DSL deployment. Because all currently deployed DSL areas are apparently profitable, excluding revenue from currently deployed DSL service causes investment in DSL to appear less profitable in the aggregate than it actually is. Yet, Section 13-517 directs that ILECs provide advanced services so that in the aggregate, 80% of the ILEC's customers have advanced services. In order to determine whether it is economically rational to meet that goal, or whether it is appropriate to grant a waiver, the Commission must consider what service to 80% of Verizon's service territory would cost. Carving out areas that already have service distorts the analysis of whether providing service to 80% of Verizon's customers would constitute an undue economic burden or adversely affect users of telecommunications services generally.

The estimates Verizon produced mismatched revenues and costs, are inconsistent with Verizon's waiver requests, and include unrelated costs. In its Direct Testimony, Verizon presented conflicting explanations of its cost and revenue data. Mr. White said that his data showed the estimated costs to support DSL to "at least 80% of the customers in each of the sample offices." By contrast, Mr. Trimble suggested that the estimated cost corresponded with deployment in 376 exchanges, "which would allow Verizon to offer a DSL transport service . . . [to] 80 percent of the company's customer base." Ver. Ex. 2.0 at 14

According to the AG, costs were determined on an exchange basis while revenues were projected based on the total number of customers not served by current DSL deployment. This creates a mismatch between the costs and the revenues because not all lines in the served exchanges are DSL-capable. Neither Mr. Trimble nor Mr. White, in Direct or in Rebuttal Testimony, applied the revenues from a particular exchange to the costs for that particular exchange, although Staff conducted that analysis, as seen in its Late Filed Exhibits 2, 4, and 6.

In addition the AG asserts that Verizon selectively and inconsistently used aggregate data in its presentation. It did not aggregate the costs and revenues for all DSL deployment, so that more or less costly areas would balance each other out. This overall aggregation would have more directly addressed the statutory 80% threshold, because it would have shown the cost for the Verizon service area as a whole. Section 13-517 requires that 80% of all Illinois customers served by an ILEC be offered advanced services, and by omitting provisioned DSL from its data, Verizon has prevented the Commission from discerning the cost to reach 80% in the aggregate.

In addition to preventing the Commission from determining whether service to 80% of Verizon's Illinois customers was economically viable, or unduly burdensome, Verizon's presentation of aggregate, incremental data was distorted by a relatively small number of extremely expensive exchanges. Mr. White pointed out that outside plant investment is needed to reach only 11% of Verizon's unserved customers. Given that outside plant investment accounts for between 227% and 312% more than all other identified investment, the effect of serving this 11% was to radically increase aggregate costs while the revenues associated with these less dense areas were insufficient to cover the higher cost. This enabled Verizon to show that, in the "aggregate of the increment", it is not economical to expand DSL service despite the fact that service to almost 70% of Verizon's customers required no outside plant investment at all. Verizon lumped all "incremental" exchanges together despite greatly differing cost characteristics among the group.

Verizon's data suffer from a problem that commonly arises when averages are used, and the effect of outliers is not addressed. For example, if a group of people is in a room, and Bill Gates walks in, the average income of the group has suddenly skyrocketed, even though the real income of each member of the group has been unaffected. In Verizon's case, the cost of serving 80% of the customers in some exchanges was several times greater than the cost to serve 80% in another exchange. Staff's presentation shows that DSL deployment would break even in 270 exchanges if all costs and revenues for the group of incremental exchanges were taken as an aggregate. Staff Late Filed Ex. 2 at 28. This presentation also showed that DSL deployment to 117 exchanges would be profitable without any intra-exchange aggregation. Staff Late Filed Ex. 4 at 12. The evidence, which Verizon claimed justified a "full waiver," or even a waiver in areas lacking current deployment, in fact justified deployment in 270 exchanges if costs and revenues are fully distributed across the

exchanges, or to 117 exchanges with each exchange self-sufficient in terms of profitability.

The problem with Verizon's aggregate/incremental approach is that high cost exchanges drive the aggregate up so much that lower cost, higher revenue exchanges are unable to bring the average down to a reasonable level. Further, the lower cost/higher revenue exchanges currently served were excluded from Verizon's analysis, giving the higher cost/lower revenue areas more weight than they would have had if a truly aggregate (not incremental) analysis been presented.

In addition, Verizon's data cannot be relied on to justify Verizon's waiver request because Verizon was never able to specify exactly how or whether its cost and revenue analyses corresponded to the requested waiver area. In his Surrebuttal Testimony, Mr. Trimble described the waiver area as all lines not currently DSL qualified. By contrast, at the hearing, Mr. Trimble suggested that the waiver area included only those exchanges or central offices with no DSL-qualified lines. Yet, the cost analyses included service to customers in exchanges where DSL is offered, but does not reach some customers. In other words, although the costs were presented as applying to the unserved exchanges, Mr. Trimble testified that his "least cost approach" included costs associated with exchanges where 80% of the customers are already served, and which Mr. Trimble suggested were not part of the waiver area.

If lines in a DSL exchange which are not served are not part of the waiver area, the costs associated with serving those customers should not be included in Verizon's incremental, least cost analysis. Yet, Mr. Trimble stated on cross-examination that such lines were in fact included. According to the AG there is a mismatch between the "least cost" analysis and Verizon's final waiver request.

People's witness William Dunkel also pointed out that Verizon included costs in its analysis that were associated with voice service and therefore should not have been included in the DSL cost estimate. The cost figures improperly included maintenance costs attributed to maintaining old copper cables that will be replaced by new fiber-optic cable during the process of deploying DSL to 80% of Verizon's customers. In its Surrebuttal Testimony, Verizon claimed that these costs were properly included because the fiber-optic cables "would not be a replacement for the cable that feeds narrowband customers" and Verizon would continue to use and maintain the copper cables to provide voice services. Ver. Ex. 6.0 at 4; Tr. at 147. During cross-examination, however, Verizon witness Trimble agreed that the Company did not intend to recommend that costs associated with voice service be included in the "incremental costs for deploying DSL." Tr. at 514.

Verizon's inclusion of maintenance expenses for copper feeder cables used for voice services in the cost of providing DSL service is improper because voice service is not a part of providing DSL service. Maintaining the old copper cables is not required in order to provide DSL service from remote terminals once these remotes are fed by fiber-optic cable. Consequently, this cost item should not have been included in

Verizon's cost estimates, and it improperly increased the incremental cost estimates Verizon provided in this docket.

The AG next asserts that, assuming that Verizon met its burden of specifying the relief that it seeks and providing sufficient supporting information, the Commission should not grant a waiver applicable to the 69.9% of Verizon customers to whom DSL can be made available through central office deployment. The evidence demonstrates that DSL can be provided to 69.9% of Verizon's Illinois customers without expensive outside plant investment, and that such deployment would not be an undue economic burden or have a significant adverse effect on users of telecommunications generally.

According to the AG, if the information Verizon presented in its Petition and testimony demonstrates anything, it demonstrates that deployment of DSL to at least 69.9% of Verizon's customers will not be an undue economic burden. These customers can be served from their Verizon central office, without expensive outside plant investment. Consequently, there is no reason for the Commission to grant a waiver of Verizon's obligations under Section 13-517 relative to those customers. Verizon's unadjusted cost studies demonstrate that the anticipated revenues from offering DSL services to 69.9% of its customers will cover all costs and generate a reasonable profit.

In his Surrebuttal Testimony, Verizon witness Trimble downplayed the significance of the People's demonstration that DSL deployment to 69.9% of Verizon customers would be profitable, stating that, "an appropriate analysis would minimally look at the net present value of the cash flows over the revenue producing life of the equipment." Ver. Ex. 7.0 at 19. During cross-examination and in response to this observation, the People introduced a net present value analysis based on the service life that Verizon assumes for DSL equipment in its ACF analysis, demonstrating that DSL capability deployed to 69.9% of Verizon's customers has a positive net present value. Consequently, as deployment to 69.9% of Verizon's customers has a positive net present value, such deployment cannot be considered to be any kind of economic burden, undue or otherwise, and it will not have an adverse impact on users of telecommunications services generally under Section 13-517(b)(1).

Further, a waiver of Verizon's section 13-517 obligations for any more than 10.1% (in addition to the 20% not required to be served under the statute) of its customers would not serve the public interest, convenience and necessity as customers for whom DSL can be provided at a reasonable cost would be denied that service. A waiver for the remaining 10.1%, however, should not extend more than one year until January 1, 2006, due to the deficiencies in Verizon's data. This will give Verizon extra time to serve the remaining 10.1% by DSL deployment or other technology, or to gather and present the necessary information to support a further waiver.

The People conclude by first recommending that the Commission deny Verizon's request for "certification" that its provision of expensive advanced services other than DSL satisfies the statutory requirement that advanced services be provided or offered to 80% of its customers and second, that if the Commission determines that some waiver

is necessary, that waiver should apply to no more than 10.1% of Verizon's customers (in addition to the 20% already excluded under the statute).

## **C. Staff Position**

### **1. Summary**

Staff begins by asserting that Verizon's request that the Commission certify its compliance with the requirements of Section 13-517(a) constitutes an improper request for a declaratory ruling under Section 5-150 of the Administrative Procedures Act and Section 200.220 of the Commission's Rules of Practice, and that Verizon's request also embodies assumptions that are contrary to the intent of the Legislature in enacting Section 13-517. Staff continues by asserting that granting Verizon's certification request would require the Commission to interpret Section 13-517 in a way that would render it meaningless (as all Illinois ILECs would have been in compliance prior to its enactment) and that even if the legal and interpretational defects of Verizon's request were ignored, its request for certification should be denied because the evidence indicates that the services proffered by Verizon are not offered to residential and small business customers. Staff further asserts that Verizon's data suffers from significant defects negating any possible showing of compliance. Finally, Staff argues that Verizon's contention that certification based on FR, ATM and HCD services is required (because the only other service for compliance is an interstate service – DSL -- not within the jurisdiction of the state) must be rejected.

In terms of Verizon's waiver request, Staff begins by asserting that Verizon has not conclusively proven that any of the statutory criteria are met and that a full waiver of unlimited duration is necessary. Staff notes that while Verizon has offered some evidence that with no waiver whatsoever, compliance with the requirements of Section 13-517 might result in an adverse economic impact on users generally, that same evidence indicates that Verizon should be able to offer and provide advanced services in significant portions of its service territory with no adverse economic impact on users generally.

According to Staff, its analysis of Verizon's data demonstrates that Verizon can comply with Section 13-517(a) for a substantial number of the exchanges and customers for which it requests a waiver without experiencing or being subjected to any of the statutory waiver conditions relied upon for the waiver request. Thus, Staff's analysis shows that Verizon can avoid the statutory conditions relied upon for a waiver through a more limited waiver. For that reason, a full waiver is not allowable under the applicable legal standard.

Although Staff finds Verizon's case unproven, it does not recommend that the Commission completely disregard the information submitted by Verizon in this proceeding. The information submitted by Verizon suggests that deployment in a number of its exchanges may generate costs in excess, potentially far in excess, of revenues that are expected from deployment. For certain of these exchanges it is highly

probable, in Staff's estimation, that this conclusion would not change even if Verizon had modified its filing in all respects to address Staff's criticisms. To that end, Staff recommends that the Commission consider the potential harm to users of telecommunications services in these and other exchanges if Verizon is not relieved of its Section 13-517(a) obligations to offer or provide advanced services in these exchanges. Staff notes that, while Verizon has not requested a partial waiver in the event that its requested waiver request is denied, the Commission should consider granting Verizon a limited duration extension for certain of its exchanges, specifically that set of exchanges for which Verizon cannot -- according to the Staff exchange level analysis -- deploy advanced services without potentially causing a significant adverse impact on users of telecommunications services. These exchanges are identified in Staff Late Filed Exhibit 2.

## **2. Certification Facts**

Verizon contends that it is in compliance with the requirements of Section 13-517(a) because it offers various transport services at speeds in excess of 200 kbps. Verizon witness Mr. Trimble summarized the four high speed services the Company offers in Illinois: Frame Relay ("FR"), Asynchronous Transfer Mode ("ATM"), High Capacity Digital ("HCD") and Digital Subscriber Line ("DSL") services. "Using switched access lines in-service as a surrogate for end-user customers," Verizon submits that its FR, ATM and HCD services are "available" in areas that contain over 80 percent of its switched access lines. Verizon Ex. 2.0 at 5-6, Table 1.

Verizon conceded that the services are non-supported services (i.e., not subject to universal service support) and that rates for these services range "from about \$500 per month" for DS-1 transport service and more for some of the others. In contrast, the month-to-month rate for Verizon's most common DSL transport service is \$39.95. Verizon also admits that "DSL is likely to be the minimum-cost method today for ILECs to deploy broadband transport . . . ." Verizon Ex. 2.0 at 9. Verizon admits that its interstate DSL transport service is "the only other viable advanced service that is offered by Verizon . . . ." Verizon Ex. 2.0 at 4. Verizon witness White testified that the products "are already available to any Verizon customer today." Verizon Ex. 3 at 2. Mr. White specifically referred to "ATM, Frame Relay, and DS-1/DS-3, with DS-1 service being available ubiquitously throughout the Verizon footprint in Illinois." Staff notes, however, that Mr. White did not know whether those services would be considered interstate or intrastate services or sold under interstate or intrastate tariffs, and that Mr. White was unable to testify as to the number or percentage of Verizon's end users that currently utilize any of these services.

Mr. White testified that DS-1 provides data speeds of 1.544 million bits per second ("MBPS") in both directions, and can be provisioned to "virtually all customers on demand utilizing copper loops with HDSL technology or with fiber when available." Verizon Ex. 3.0 at 3. Mr. White also explained Verizon's Frame Relay and Asynchronous Transport Mode ("ATM") services. Mr. White testified that these services are available to 80% of Verizon's customers provided "that the customers are willing to

cover the costs of any central office ('CO') and outside plant ('OSP') modifications (where required), as well as pay the monthly tariffed rate." *Id.* at 3-4. Mr. White explained that the DS-1 service is part of a new model that has many customers sharing a common high-speed backbone, thereby, dramatically reducing costs and that any type of loop modem could be installed on a copper loop ranging up to 18,000 feet. The loop would then be aggregated in a Digital Subscriber Line Access Multiplexer ('DSLAM')." Mr. White testified that this shared transport or packet transport model became a basic design of new networks built by ILECs, CLECs, Wireless Networks and Cable Networks.

Mr. White testified that when the shared transport or packet transport model is deployed without significant customer demand, it can be more costly than point to point or dial-up technologies due to unused capacity. Mr. White further testified that Verizon's decision not to deploy a new data only network was driven by the fact that competition and customer expectations significantly limit the ability to charge, and hence, generate revenue from new services.

### **3. Certification Arguments**

Staff begins by pointing out that Section 13-517 nowhere provides for Commission certification of compliance with Section 13-517(a). Staff then argues that Verizon's request is an improper request for a declaratory ruling where no current enforcement action is pending, threatened or contemplated. Indeed, the requirements of Section 13-517(a) do not become effective until January 1, 2005. Thus, given the lack of an actual case or controversy, this request is premature and would require the Commission to pass judgment on mere abstract propositions of law, or render an advisory opinion. At best, Verizon's request for certification seeks a declaratory ruling not permitted by law.

The Commission's authority to issue a declaratory ruling is derived from Section 5-150 of the Illinois Administrative Procedure Act ("APA"), as applied by Section 10-101 of the Public Utilities Act. See 5 ILCS 100/5-150. Section 5-150 of the APA provides that "[e]ach agency may in its discretion provide by rule for the filing and prompt disposition of petitions or requests for declaratory rulings . . . ." 5 ILCS 100/5-150(a). In accordance with Section 5-150 of the APA, the Commission promulgated a rule to allow requests for declaratory rulings as Section 200.220 of its Rules of Practice. 83 Ill. Adm. Code 200.220. Section 200.220 of the Commission's Rules of Practice limits the issues for which a party may seek a declaratory rulings as follows:

- a) When requested by the affected person, the Commission may in its sole discretion issue a declaratory ruling with respect to:
  - 1) the applicability of any statutory provision enforced by the Commission or of any Commission rule to the person(s) requesting a declaratory ruling; and
  - 2) whether the person's compliance with a federal rule will be accepted as compliance with a similar Commission rule.

83 Ill. Adm. Code 200.220.

Thus, according to Staff, a party may only seek a declaratory ruling from the Commission with respect to (1) whether a law or rule applies to the party seeking the declaratory ruling, and (2) whether that party's compliance with a federal rule will constitute compliance with a similar Commission rule. Verizon's request fits into neither of these allowable grounds for a declaratory ruling.

Staff goes on to argue that it has long been settled that the Commission has no authority to issue a declaratory ruling absent adoption of a rule consistent with the requirements set forth in Section 5-150 of the APA. *Harrisonville Telephone Company v. Illinois Commerce Commission*, 176 Ill App. 3d 389, 393 (5<sup>th</sup> Dist. 1988) Accordingly, Verizon's request that the Commission certify its compliance improperly seeks a declaratory ruling and must be denied.

In terms of the *bona fides* of Verizon's request for certification, Staff asserts that Verizon's claims in this regard should be rejected because they are based on faulty assumptions and interpretations. In addition, however, the Commission must reject Verizon's claims because acceptance of them would require, from both a legal and policy standpoint, an unreasonable and unsupportable interpretation or understanding of Section 13-517.

Staff begins by noting that ATM, FR and HCD services pre-date the enactment of Section 13-517, a situation that is also true for all other ILECs in Illinois. Because of this, the Commission's acceptance of Verizon's claims of 100% coverage (which rely on these three offerings) would necessitate similar treatment of such claims by other ILECs. Consequently, Verizon's assertion that ATM, FR and HCD offerings demonstrate Section 13-517 compliance would, if accepted, result in findings that all or virtually all ILECs already met the requirements of Section 13-517 as of the date of its enactment. This is unreasonable on its face, since in effect this would presume that the General Assembly drafted Section 13-517 to serve no purpose. According to Staff, such an interpretation of Section 13-517 is inconsistent with the well established rule of statutory construction that prohibits statutes from being interpreted in a manner that renders words or phrases meaningless. See e.g., *Best v. Taylor Mach. Works*, 179 Ill. 2d 367, 422 (1997), citing *Kraft v. Edgar*, 138 Ill. 2d 178, 189 (1990).

In addition to addressing the impact of Section 13-517 on Verizon's current high speed offerings, Staff also addressed Verizon's purported compliance with its dictates. Staff begins by noting that the Act does not define the terms "offer" or "provide." Neither does it outline when or how advanced services should be deemed offered or provided to "customers." Staff witness Dr. Liu recommended that the Commission apply fundamental economic principles in assessing whether Verizon's proposal squares with the Act's requirement that a carrier offer or provide advanced telecommunications services to 80% of its Illinois customers.

Dr. Liu explained that a service “offering” is associated with a market to which the service is being marketed, and the rates at which the service is offered. Dr. Liu testified that fundamental economic principles establish that rates for telecommunications services are determined based on the demand and supply in the market for the service. If the rates for a service are neither based on the demand and supply for a particular customer group nor set to attract that customer group, then that service should not be considered to be offered to that customer group. In other words, there should be a reasonable expectation that customers would purchase a service (at the offered rates) before that service is deemed to be an offer to those customers. A determination of whether an ILEC “provides” a service is a customer specific fact based inquiry. Dr. Liu testified that providing a service is equivalent to provisioning a service and that a carrier provides a service to a customer if the customer is actually taking the service.

Dr. Liu also addressed the issue of whether Verizon’s customers should be considered as separate sets of customers (i.e., residential/small business customers and big business customers) for purposes of determining whether particular advanced services are offered to 80% of its customers. Dr. Liu concluded that the Commission should look at residential/small business customers and big business customers separately in identifying what advanced services Verizon offers to its customers. Dr. Liu explained that:

Residential and small business end-users have very different demand and affordability characteristics compared to big business end-users. Big business end-users generally have significantly greater willingness and ability to pay than residential and small business end-users. Carriers generally offer big business end-users voice telephone services with more capacity, features and capability and at higher rates than residential and small business end-users. Similarly, the advanced services that Verizon offers to residential/small business end-users are different from the set of advanced services that Verizon offers to its big business end-users. Therefore, it is important to treat residential/small business end-users and big business end-users separately in identifying the sets of advanced services that Verizon offers to each set of end-users.

ICC Staff Ex. 1.0 at 17.

According to Staff, Verizon’s view of its requirement to “offer” advanced telecommunications is much more lax. Although not specifically addressed in its direct testimony, Verizon did define the phrase “offering advanced services” in its response to Staff data requests by responding that offering advanced services means that Verizon has tariff provisions that permit interested customers to obtain the specific services based on published terms and conditions and that offering means that Verizon has established processes and rates that allow it, at a customer’s request, to make the service available. As observed by Dr. Liu, Verizon “acknowledges that a service offering is associated with the *rates* at which the service is being offered or made available.”

Thus, according to Staff, Verizon does not dispute the underlying fundamental economic principles upon which Dr. Liu's analysis and conclusion are based.

Therefore, Staff submits that (1) any determination of whether Verizon offers a service to its customers must take into account Verizon's different customer classes; and (2) Verizon should not be deemed to "offer" a service to a customer unless there is a reasonable expectation that customers within the customer class being considered would purchase such services at the offered rates.

Staff then discusses whether or not Verizon's high speed offering should be deemed to be "offered" to 80% of its Illinois customers as required by statute. Staff notes that Dr. Liu analyzed Verizon's claim that it offers FR, HCD, and ATM advanced services to its residential and business customers. Consistent with her earlier testimony, Dr. Liu analyzed Verizon's claim with respect to the big business and residential/small business customer groups. First, Dr. Liu pointed out that while the company did not provide information separately identifying the number of big business customers, she nonetheless agreed that Verizon offers or provides FR services to its big business customers. Dr. Liu noted that FR services are offered at several speeds exceeding 200 kbps and are chiefly marketed as alternatives to dedicated-private lines, which are marketed to big business end-users. Thus, Dr. Liu found it reasonable to conclude that Verizon offers and markets its FR services to its big business customers.

Similarly, Dr. Liu found that Verizon offers ATM services to its big business customers. Dr. Liu testified that ATM is more expensive than FR and can handle a wider range of service classes and at higher operating speed than FR. Based on the fact that FR is marketed to big business end-users, Dr. Liu agreed that Verizon offers and markets ATM services to its big business end-users as well.

Dr. Liu also found that Verizon offers HCD services to its big business customers. Dr. Liu explained that HCD services are a type of Special Access services and provide high-capacity-digital point-to-point dedicated transmission and are marketed to big business end-users. Based on these facts, Dr. Liu concluded that Verizon offers HCD services to its big business customers.

Dr. Liu then analyzed whether Verizon should be found to offer ATM, FR, and HCD advanced services to residential/small business customers. Dr. Liu first pointed out that while the Company did not provide information separately identifying the number of residential/small business customers, she was nonetheless able to conclude that Verizon does not offer FR services to its residential/small business customers. Dr. Liu testified that FR services are primarily intended for LAN-to-LAN internetworking applications, and FR networks are chiefly marketed as alternatives to dedicated-private lines, which are big business end user services. Dr. Liu explained that FR is intended for the big business market rather than the residential/small business market, and the rates set by Verizon are based on demand and supply characteristics in the big business market for FR services and that the rates for FR services are not attractive to residential/small business customers.

For example, Dr. Liu testified that the lowest speed FR (port and access) services would cost \$395 in nonrecurring charge and \$285 in monthly recurring charges; and DS1 FR (port and access) services would cost \$595 in nonrecurring charge and \$530 in monthly recurring charge. Dr. Liu further testified that there can be no reasonable expectation that any residential or small business end-users would purchase FR services at these offered (tariffed) rates. For all the above-stated reasons, Staff concludes that Verizon does not “offer” FR advanced services to its residential/small business customers.

Dr. Liu similarly concluded that Verizon does not offer ATM services to its residential/small business customers. Dr. Liu explained that ATM is very high-speed transmission technology, and is capable of supporting a wider range of service classes and at greater operating speeds than FR. ATM is also more expensive than FR. Based upon her conclusion that FR services are chiefly marketed to big business end-users (and not to residential or small business end-users), Dr. Liu concluded that the faster and more expensive ATM services would also be more likely to be marketed to big business end-users (and not to its residential or small business end-users).

Dr. Liu noted that under Verizon’s tariffs the lowest speed ATM services meeting the speed requirements of Section 13-517(c) would cost \$650 in non-recurring charge and \$650 in monthly recurring charge for the access channel (‘port and access’) in addition to monthly recurring charges for Sustained-Cell-Rate (SCR), which range from \$63 to \$1,305 for CBR (Constant-Bits-Rate). Dr. Liu testified that these rates are not set to attract residential or small business end-users, and there can be no reasonable expectation that any residential or small business end-users would purchase ATM services at the tariffed rates. Based upon Dr. Liu’s testimony, Staff concludes that Verizon does not offer ATM services to its residential/small business customers.

Dr. Liu’s analysis of Verizon’s HCD services similarly revealed that Verizon does not offer HCD services to its residential/small business customers. Dr. Liu explained that HCD service is a type of Special Access service that provides a point-to-point high-capacity-digital dedicated transmission path. Dr. Liu testified that it is well known that Special Access services are marketed to big businesses, and therefore concluded that Verizon markets its HCD services to big business customers (not residential/small business customers). This conclusion was further supported by Verizon’s tariffed rates for HCD advanced services, which according to Dr. Liu, were not set to attract residential/small business users, and without any reasonable expectation that any residential or small business end-users would purchase Verizon’s HCD services at the offered (tariffed) rates. Staff similarly concluded that Verizon does not offer HCD services to its residential/small business customers.

Dr. Liu’s analysis was further supported by her analysis of Verizon’s provisioning of FR, HCD and ATM services. Verizon’s responses to Staff Data Requests indicated that Verizon currently does not provide FR, HCD or ATM services to any of its residential end-users at the tariffed rates. Thus, none of Verizon’s residential customers

currently purchases (or subscribes to) its FR, HCD or ATM services at the offered or tariffed rates. This data confirms Dr. Liu's conclusion that the tariffed rates for these services are not attractive to any of the company's residential customers, and verifies the expectation that no residential customers would purchase (or subscribe to) Verizon's FR, ATM or HCD services at the offered or tariffed rates.

This data also supports Dr. Liu's conclusions that these services are not attractive to or likely to be purchased by small business customers. Dr. Liu testified that small business customers share similar characteristics with residential customers. Given that none of the company's residential customers purchase Verizon's FR, HCD, or ATM services, Dr. Liu found it reasonable to presume that none or few of the company's small business customers would purchase (or subscribe to) Verizon's FR, HCD or ATM services and that Verizon provided no evidence that would rebut this reasonable presumption. Dr. Liu further testified that information provided by Verizon for all business customers (undifferentiated numbers for big and small business customers combined) shows low provisioning levels for these services generally. These low provisioning numbers are consistent with Dr. Liu's presumption that these services are not provided to small business customers.

Dr. Liu also acknowledged Verizon's deployment of DSL in a limited number of its exchanges and agreed that Verizon offers DSL services to some of its residential/small business end-users. In response to Staff data requests, Verizon stated that it currently sells DSL transport services primarily to ISPs who then package DSL with their internet service offerings. Dr. Liu testified that DSL transport services in an exchange would be of no value to the buyers if no ISP is willing to provide DSL Internet access in that exchange because DSL transport services are primarily used in conjunction with internet access. Dr. Liu noted that Verizon did not indicate in its direct testimony whether it had signed up with an ISP in its DSL deployed exchanges. Dr. Liu testified that offering DSL transport services in an exchange without signing up with any ISPs would, from the end-users perspective, not be an offer at all.

Dr. Liu ultimately concluded that DSL services are the only type of advanced services that Verizon currently "offers" to its residential/small business customers. DSL services are also the only type of advanced service that Verizon makes available to its residential/small business end-users (in some of its serving areas) at rates that can be attractive to and that are intended to attract and be affordable to these end-users.

Dr. Liu then testified that a major deficiency in Verizon's assessment of its advanced services offerings is that it does not provide a definition of customers for purposes of Section 13-517 of the PUA. Dr. Liu explained that Verizon also failed to assess the number of "customers" to whom it offers and provides advanced services in a clear, meaningful and consistent manner because, while it used various proxies or surrogates for customers throughout its case, the Company's proxies or surrogates vary throughout its testimony and responses to Staff data requests.

Dr. Liu provided several examples of Verizon's inconsistent presentation of customer data. Verizon used switched access lines as a proxy (or surrogate) for end-user customers to calculate existing advanced services coverage. Verizon's data request responses indicate that the number for "business and residential customers" provided later in that same testimony (and used in developing DSL revenue estimates) was based on a subset of access lines. The universe from which the subset was derived was not initially provided, although Staff subsequently determined that this number was derived by applying an 80% coverage figure to the number of access lines in the active-DSL exchanges.

In calculating the coverage statistic for its DSL service offering, Verizon uses yet another proxy -- households and business establishments -- for customers. Verizon also used billing accounts as a proxy for "customers" in certain data request responses. Verizon's data sometimes employed different proxies for similar numbers, such as using billing accounts to quantify the number of business customers and some proxy other than billing accounts to quantify the number of business customers who have been provided HCD services. As Dr. Liu testified, "[t]hese examples demonstrate that the company not only did not provide an explicit definition of 'customers', but also it did not adopt or use a proxy for the term 'customers' in a consistent and clear manner." ICC Staff Ex. 1.0 at 43.

Dr. Liu also observed that when Verizon uses access lines as a proxy for customers, those numbers do not include access lines served by CLECs through Verizon's network facilities. According to Dr. Liu, end-users that are provided with telecommunications services by a CLEC through the ILEC's network facilities should be included as customers of the ILEC for purposes of determining whether or not the customer is being provided advanced telecommunications services.

Dr. Liu testified that it is not appropriate for Verizon to assess the numbers of customers offered advanced services in terms of access lines, or to tie the offering of advanced services to access lines, because it is the end-user customer -- not access lines -- that is the explicit focus of Section 13-517. The use of access lines as a measurement device also runs the risk of not identifying customers to whom Verizon does offer an advanced service. Further, there is no fixed and definite relationship between the number of access lines and the number of lines offered advanced service. Dr. Liu noted that if Verizon offers a specific advanced service in a particular exchange, then Verizon considers itself to offer that particular advanced service to each access line (as a proxy for "customer") within that exchange. According to Dr. Liu, this assumption defies logic, as a single customer can have multiple access lines. In addition, this approach substantially overstates Verizon's coverage statistics in those exchanges, and overstates the overall coverage figures for such services.

Dr. Liu noted by way of example that despite the fact that she had concluded that the company does not offer FR or ATM or HCD services to its residential or small business customers, Verizon's analysis results in its conclusion that it does offer FR (or ATM) services to 100% of its "customers" (using access lines as the proxy) in

exchanges where it offers FR (or ATM) services. According to Dr. Liu, this leads Verizon to incorrectly claim to offer these services to customers to whom it does not offer such services (i.e., residential and small business customers).

Dr. Liu testified that Verizon appears to apply different standards to quantifying customers when it describes its HCD service offering and when it describes its HCD service provisioning. Specifically, the Company uses (switched) access lines as the surrogate for customers when it describes its HCD service offerings, and uses billing accounts when it describes its HCD service provisioning. This same criticism applies to Verizon's FR and ATM services. Verizon uses (switched) access lines as the surrogate for customers in assessing its FR and ATM service offerings, but uses "ports" as the proxy when assessing the FR and ATM services it actually provides. There is no clear relationship between the "ports" provided by Verizon and the access lines -- i.e., FR (or ATM) lines -- offered by Verizon. Thus, Dr. Liu concluded that it is not possible to identify (or calculate the number of) the customers to whom the company currently provides FR (or ATM) services (from the larger set of customers to whom it offers FR (or ATM) services).

Verizon's DSL coverage statistics suffer from similar problems. The Company calculated its current DSL coverage by dividing the number of qualified DSL lines by the total number of households. If the Company is going to use a proxy for customers, then its determination of the ratio of qualified DSL customers to total customers (i.e., customers offered DSL advanced services) should be based on a numerator and denominator that use the same proxy. Dr. Liu recommended that the company define a DSL line as a line that is DSL-capable and over which DSL services are offered. Such an approach would better focus on the number and percentage of customers to whom DSL services are offered, rather than the number and percentage of lines that satisfy certain engineering parameters. As noted by Dr. Liu, Verizon's coverage calculation simply gives the number of DSL-capable lines per household, which does not have much bearing on the percentage of customers that have been offered DSL services.

Verizon's calculation of its DSL service coverage in Table 1 of Mr. Trimble's direct testimony suffers from further flaws. Verizon used households as a proxy when counting the total number of its customers (the denominator). Households, however, is not a good proxy for customers, as it does not count for (small or big) businesses. Verizon's calculation further suffers from the fact that the numerator (expressed in access lines) counts businesses as well as residential customers. Therefore, not only are Verizon's numerator and denominator measured in different units, they also count for different sets of "customers" — with the numerator reflecting both residential and business, and the denominator reflecting only residential.

Dr. Liu went on to note that it also appears that Verizon has misclassified as FR and ATM advanced services specific offerings that do not qualify as advanced services under Section 13-517. In its response to Staff Data Request QL-11, Verizon stated:

Verizon offers “port only” service to any customer willing to purchase the service. Bundled, i.e., “port and access”, service is offered *where conditions and facilities exist*. Therefore, a customer who may not be able to purchase bundled service (e.g., their location is beyond a typical port and access service area) may purchase port only and separately provide the necessary transport into the Verizon Frame Relay switch. [Emphasis added].

ICC Staff Ex. 1.0 at 46.

According to Dr. Liu, Verizon’s response indicates that the Company does not offer “port and access” FR services to 100% of its (big business) customers, even though it may offer port only FR service to 100% of its (big business) customers. Dr. Liu explained that “port only” FR service can not be classified as an advanced telecommunications service under Section 13-517 because “port only” FR service does not, by itself, deliver information to or from the end-user at any speed. Therefore, according to Dr. Liu, Verizon has overstated its FR service offering in each of its exchanges.

Dr. Liu explained that ATM advanced services are also subject to the “port only” misclassification problem discussed above. That is, “port only” ATM services do not qualify as advanced services for purpose of Section 13-517 because they do not deliver (data) information *to* or *from* the end-user. Therefore, Verizon has overstated its ATM service offering coverage.

Staff also responded to Verizon’s jurisdictional arguments that the requirements of Section 13-517 may be met by its intrastate high speed services and do not require the deployment of DSL based upon its view that interstate services are not within the jurisdiction of the state. Staff asserts that Verizon’s arguments are in error for several reasons. First, the Commission is not requiring Verizon to do anything – the Legislature has already done that. With respect to the State Legislature, Staff does not share Verizon’s view that a jurisdictional issue is presented.

Staff points out that the Commission was presented with a similar issue in connection with Section 13-801 of the PUA, another provision enacted along with Section 13-517 as part of Public Act 92-0022. There, the Commission rejected outright attacks on the propriety of the legislative mandates contained in Public Act 92-0022 by stating:

30. Second, Ameritech argues that Public Act 92-0022 has imposed obligations upon Ameritech that are inconsistent with federal law and therefore, go beyond the state authority. Ameritech also argues that the Illinois General Assembly is preempted from deviating from the federal standard. AI Brief at 110.

31. For argument’s sake, even assuming Ameritech to be correct that the additional obligations imposed by the legislature are inconsistent

with federal law and, as a result, the Illinois General Assembly has acted outside of its state authority, this argument cannot but fail at the Commission. Until Public Act 92-0022 has been overturned on that basis, this Commission has no choice but to follow state law. Ameritech's remedy is to seek to overturn the legislation, not to ask this Commission to countermand it.

32. Moreover, Ameritech has not made its case that the additional obligations imposed by Section 13-801 are inconsistent with federal law

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\* \* \*

34. Ameritech also argues that the Illinois General Assembly is preempted from deviating from the federal standard. AI Brief at 110. This argument must fail for the same reasons stated above. If Ameritech believes that the State legislature acted improperly, its remedy is to challenge Public Act 92-0022, not to ask this Commission to second-guess the legislature.

Illinois Bell Telephone Company: Filing to Implement Tariff Provisions Related to Section 13-801 of the Public Utilities Act, ICC Docket No. 01-0614, Order at ¶¶ 31-34 (July 11, 2002). Staff urges the Commission to reject Verizon's argument on similar grounds.

Further, according to Staff, there is no basis to assume that federal law preempts state and local regulations such as Section 13-517 of the PUA. Section 253 of the Federal Telecommunications Act provides,

"No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service."

47 U.S.C. § 253(a)

Conversely, the same section of the Federal Act, Section 253(b), confers the following authority to the states:

"Nothing in this section shall affect the ability of a State to impose on a competitively neutral basis and consistent with section 254, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers."

47 U.S.C. § 253(b)

According to Staff, this provision is clear and unambiguous. Evidence regarding preemptive legislative intent underlying a particular statute should be found in the text and structure of the statute itself. Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 95, 77

L.Ed.2d 490, 103 S.Ct. 2890 (1983). With respect to Section 252(b) of the Federal Act, the language on the face of the statute declares its clear meaning, which is, confer States with an autonomous ability to legislate for purposes of protecting the interests of the State. That is, Section 252(b) bestows States with the right to enact laws and regulations for purposes of, *inter alia*, safeguarding and protecting the interest of the State and its citizens. No other reasonable interpretation can be advanced in good faith.

Further, the United States Supreme Court has held that “[i]n the interest of avoiding unintended encroachment on the authority of the States, . . . a court interpreting a federal statute pertaining to a subject traditionally governed by state law will be reluctant to find preemption.” CSX Transp. v. Easterwood, 507 U.S. 658, 664, 113 S.Ct. 1732, 123 L.Ed.2d 387, (1993).

Section 252(b) of the Federal Act does not foreclose States or State commissions from imposing additional obligations on carriers as long as the additional obligations are consistent with the federal Act. This position is consistent with that taken by this Commission in its comments to the FCC in *In the Matter of the Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, May 16, 1996, pp. 18-20.

Staff concludes that Verizon’s arguments regarding the authority of the Legislature and the Commission lack any real merit.

#### **4. Waiver Facts**

Staff begins by summarizing the testimony of Mr. Walter Slagle, Manager – DSL Network Planning in the Advanced Services Group of Verizon Telecom, who presented testimony describing (i) the advanced data network (“ADN”) modifications and (ii) related central office (“CO”) infrastructure and interoffice facilities (“IOF”) modifications, as well as the costs associated with those modifications, that Verizon contends it would incur provisioning DSL to 80% of its customers in Illinois. Mr. Slagle testified that the ADN and IOF modifications consist of 5 major components:

- (1) Digital Subscriber Line Access Multiplexers (“DSLAMS”) located in the serving central office (or, at the remote terminal, if the customer is served from one) that house the DSL modems and perform aggregation of subscriber traffic to/from the ATM backbone network;
- (2) Splitter shelves that house the low pass filters/combiners and that provide for line sharing of DSL on customers plain old telephone service (“POTS”) lines;
- (3) ATM switches located in each LATA that switch DSL traffic from multiple serving office DSLAMS to the public fast packet network for ISP access;
- (4) Interoffice and/or Intra-office DS3 facilities that connect each DSLAM to its serving ATM; and
- (5) an element management network that provides for operations, administration, maintenance and provisioning functions.

Mr. Slagle testified that Verizon currently has 49 active DSL central offices in Illinois. Mr. Slagle could not identify either the total or DSL qualified access lines associated with the 21 central offices planned to be deployed by year end 2002.

Mr. Slagle estimated the ADN and IOF capital costs that Verizon would incur to deploy DSL in all of the non-active Central Offices. Mr. Slagle pointed out that his cost estimates were based on a sampling of 20 Illinois offices rather than an office-by-office analysis. The ADN figure includes all the equipment that would need to be placed in the central offices and would include the DSLAMs, ATM switches and ports on the Fast-Packet Network as well as the costs associated with the element management system. The figure excludes central offices where DSL is already deployed. The IOF figure includes the DS-3 lines between the DSLAMs and the ATM switches and the costs to get into Verizon's hubs.

Mr. Slagle's cost estimates did not include additional capital costs for deploying to remote terminals and other outside plant ("OSP") costs. Mr. Slagle's cost estimates also did not include the costs incurred by Verizon with respect to the 49 active DSL central offices. Rather, his cost estimates (i) represent the additional equipment to get to 80%" (i.e., incremental deployment costs) and (ii) do not take into account what already existed in the network. Staff notes that during cross examination Mr. Slagle could not provide any information regarding the number of customers that have DSL available to them based upon Verizon's existing DSL deployment, or the costs associated with Verizon's existing deployment.

In terms of additional DSL deployment, Mr. Slagle testified that each year is assessed on its own and planning is limited to a one-year horizon. Mr. Slagle testified as follows:

I've never seen a five-year plan saying this is what we're going to do over the next five years. What we get is next year's plan.

Tr. at 133.

Mr. Slagle also testified although the ADN, IOF and OSP cost categories cover all segments of Verizon's DSL network, leased DS-3 facilities could possibly impact the IOF costs. Because Verizon's service territory contains a number of non-contiguous service areas which are separated from each other by the service territories of other ILECs, Verizon would sometimes need to lease DS-3 facilities from ILECs instead of using its own interoffice facilities. Verizon accounted for interoffice facilities cost as if it were Verizon costs rather than leased costs. The impact of leased interoffice facilities was not assessed or quantified by Verizon for presentation in this docket.

Mr. Slagle testified that even with deployment of DSL at each of Verizon's central offices, Verizon would be able to offer DSL services to only 69.9% of the access lines within its operating territory because DSL has distance limitations from the central office

based DSLAM. Mr. Slagle indicated that additional DSL equipment at remote terminals would be required in order to reach 80% of its access lines.

Staff then summarized the testimony of Mr. John White, Executive Director – Network Services within the Verizon Wholesale Services organization. Mr. White's testimony explains the costs for OSP associated with deploying facilities capable of supporting DSL.

Mr. White testified that because Verizon has a large number of central offices it would be extremely time consuming to provide a detailed estimate of OSP costs. Verizon Mr. White testified that he relied on a sample of 20 central offices to determine the estimated cost of deploying new OSP facilities and electronics to support DSL to at least 80% of the customers in each of the sample offices. These costs included costs for deployment of new fiber cable, Digital Loop Carrier sites, remote DSLAMs and additional Feeder Distribution interfaces as well as removal of existing analog loop carrier equipment. The costs for the 20 representative offices were applied proportionately to all the Verizon wire centers in Illinois. Mr. White also explained that his analysis did not account for additional variable costs such as leased interoffice facilities that are not known at this time.

Mr. White explained that while central office based DSL deployment can reach approximately 69% of Verizon's customer base, the OSP deployment costs serves to reach the additional 11% of the Verizon's customer base necessary to meet the 80% requirement of Section 13-517(a). According to Mr. White, the 69% percent of Verizon's customers that can be provided DSL through central office only deployment does not include customers provided service through fiber fed remotes.

According to Mr. White, his OSP cost estimates only include the incremental costs to go from the current DSL deployment to the 80% deployment. Mr. White could not identify the number of DSL lines currently provisioned from the 49 active DSL central offices or the number of qualified DSL lines associated with them. Mr. White explained that he did not need to know the level of existing deployment for his analysis because there was no outside plant invested so far. Staff notes that Mr. White was unable to represent, however, that Verizon had done no outside plant investment as of January 28, 2003, but he believed that to be the case.

During cross examination, Mr. White was asked to explain the outside plant costs for deploying DSL to 80% of Verizon's customers. Mr. White explained that copper plant and fiber plant provides the feeder to customers. DSL was designed to work on copper by providing a data channel on the high frequency portion of the copper that's above the voice. However, as the loop gets longer the signal gets weaker – especially in the high frequencies. Mr. White stated that the farthest distance that you can find the high frequency signal is about 18,000 feet. Thus, DSL will not work on copper loops longer than 18,000 feet.

Approximately 70% of Verizon's embedded copper plant consists of loops of less than 18,000 feet. Nonetheless, there are things that still prohibit use of DSL -- which he called interferers. Some of the interferers are the old T carriers. Another interferer is a very tiny device used to put two lines on one copper pair called an AML (additional main line or analog main line) that uses an analog signal. So one component of the OSP costs is to remove the AMLs and replace them with a modern AML that has a digital component. Only the removal of the two-line AMLs is required for Verizon to be able to bring DSL to 69.9% of its customers through central office only deployment.

Mr. White identified "larger carrier units" -- most of which go out further than 18,000 feet -- as another interferer. The OSP costs include the costs to remove the existing electronics and replace it with a new small DLC. Mr. White explained that where Verizon ran out of capacity on a 50-pair cable that fed a small town, they added the larger eight-channel carrier units to add capacity. Verizon will now install one DLC, but it still has all the other pairs working in that 50-pair cable (although it may retire up to 4 pairs out of it). Thus, there are costs for retiring the old carrier units and adding a new module. These modifications enable the copper to work.

Mr. White then explained that Verizon has eleven percent of its Illinois lines on DLC, and DSL doesn't work over DLC. Mr. White included the cost of installing remote ASLAMS, like DSLAMS, at a remote terminal and having fiber back to the central office to pick-up the additional customers to bring Verizon up to 80 percent coverage.

The OSP cost figure in Mr. White's direct testimony was to cover 80% of Verizon's lines in each central office. Mr. White explained that the alternative OSP cost number represents a different concentration of customers "[s]o that instead of going to all 413 wire centers, we would do 205 wire centers but we would do more lines in those wire centers to come up with the same macro, 80 percent of the Illinois customers." Tr. at 177.

Mr. White also indicated that Verizon's Wholesale division performed an alternative evaluation, involving a similar improvement in the OSP facilities, but limited to the largest 205 wire centers based on the premise that including the largest wire centers would make up the shortfall of lines from the CO deployment necessary to reach the 80% accessibility level for Verizon. Mr. White included an OSP cost figure for this alternative deployment that was marginally less than the cost figure propounded for the full roll out to 80 % of Verizon's access lines.

Mr. White also testified that it would be impractical to deploy DSL in exchanges with low population density. Mr. White testified it would be prohibitively expensive given the high costs and low population density. He also testified that there is no apparent demand for this type of investment.

Mr. White testified during cross examination that Verizon would not look to invest in OSP to deploy DSL in rural areas because it would not be able to aggregate "two, three, four, five hundred customers to put all of this electronics out there in order to

concentrate and utilize the backbone.” Tr. at 155-156. When asked to identify which specific exchanges should be considered as low population density exchanges, Mr. White testified that Verizon did not look at the engineering of each and every wire center and did not rank them. However, when questioned further, Mr. White testified that Verizon has:

Listed the wire centers by size. To [him], anything that’s under a thousand lines is going to be a low population density that wouldn’t justify installing a DSLAM into shared customers on. And once you go above that, they need a detailed analysis to figure out.

Tr. at 187.

Mr. Slagle also testified about Verizon’s proposed DSL Bona Fide Request (“BFR”) process. According to Mr. Slagle, the process is intended to demonstrate what the market actually desires, not what various groups believe the public wants, and will ensure that there is no economic burden on the customers or the company in the state. When asked to explain what he meant by “market desires” Mr. Slagle stated:

What we’re saying here is that the market demand is going to drive where we need DSL, and at that point rather than, you know, special interest groups saying I really need it here, the Verizon position was, hey, listen, if the market is calling for it and we can get there and there’s a high enough demand, then that’s the market [demand that we’re referring to].

Tr. at 118-119.

Although Mr. Slagle does not contend that market desire or market demand is best determined through Verizon’s proposed BFR process, Verizon would rather use a Bona Fide Request process to assess the market, assess what else is there as well as the cost. However, Verizon’s position is that deployment beyond what the market desires would always create an undue economic burden.

Finally, Mr. Slagle understood the Company to be seeking a waiver for its entire Illinois service territory. Mr. Slagle explained that the Company is seeking a full waiver, and that Verizon would decide after getting a waiver where it would deploy DSL. Tr. at 122.

## **5. Waiver Arguments**

Staff witness Dr. Qin Liu is a policy analyst in the Telecommunication Division of the Commission. Dr. Liu’s direct testimony identified the basic policy and factual questions relevant to an evaluation of Verizon’s petition for a waiver from the requirements of Section 13-517 of the Illinois Public Utilities Act (“PUA”). Specifically, Dr. Liu analyzed (i) the advanced services that Verizon North Inc. and Verizon South Inc. (collectively, “Verizon”) offer to its different customer groups, and (ii) how to assess

whether Verizon meets the conditions under which the Commission may grant a Section 13-517 waiver. Dr. Liu also provided testimony regarding economic and other considerations relevant to consideration of various terms in Section 13-517, including “offer,” “provide,” “customers,” “unduly economically burdensome,” “adverse economic impact,” and “impractical to implement.”

In her direct testimony, Dr. Liu testified that Verizon failed to provide information that is required and crucial for Staff to conduct an adequate analysis and for the Commission to have an adequate record. Based on the information provided in Verizon’s direct testimony, Dr. Liu originally recommend the denial of Verizon’s waiver request.

In terms of Verizon’s contention that deploying advanced services to 80% of its customers would be “unduly economically burdensome,” Dr. Liu began by noting that Section 13-517 of the PUA does not define or explain what should be considered “unduly economically burdensome”. Dr. Liu testified that this standard should be based on the concepts of incremental cost and incremental revenue, where “incremental costs” refer to the “extra” costs incurred if the carrier (Verizon in this proceeding) is to offer advanced services beyond its current deployment to meet the 80% requirement of the PUA and “incremental revenue” refers to the “extra” revenue that would potentially be generated from additional advanced services customers who would be afforded the opportunity to take advanced services by virtue of their required deployment. The 80% requirement of Section 13-517 of the PUA should be deemed as unduly economically burdensome if and only if the incremental cost is significantly greater than the incremental revenue of meeting the requirement.

After first noting that the test must be applied on a case by case, company specific basis, Dr. Liu stated that Verizon’s position, which would appear to be that any excess of incremental costs over incremental revenues would be unduly economically burdensome, was unreasonable on its face and should be rejected by the Commission.

Dr. Liu testified that “[i]n order to meet its burden of proof to be granted a waiver, Verizon must (i) accurately and completely identify the excess of incremental costs over incremental revenues to comply with Section 13-517, and (ii) fully develop and explain why, in relation to Verizon and its operations, such excess costs are ‘unduly economically burdensome.’” ICC Staff Ex. 1.0 at 7.

Dr. Liu also opined that Verizon appears to contend that it should receive a Section 13-517 waiver because deploying advanced services to 80% of its customers would have “a significant adverse economic impact on users of telecommunications services generally”. After noting that Section 13-517 of the PUA does not explicitly define or explain the phrase “significant adverse economic impact,” nor does it provide any guideline on how to assess or quantify the “adverse economic impact” on users of telecommunications services, Dr. Liu suggested appropriate ways to assess the “adverse economic impact on users of telecommunications services generally.” Dr. Liu explained that “[o]nly when incremental cost is *significantly* greater than incremental

revenue, would there be an *adverse economic impact* on users generally.” ICC Staff Ex. 1.0 at 8. Thus, there would not be an “adverse economic impact on users of telecommunications services generally” if Verizon’s incremental cost of meeting the 80% requirement is no greater than associated incremental revenue. See ICC Staff Ex. 1.0 at 8.

Staff posited that, given the limited data available to Staff, one way to analyze whether offering advanced services could be considered unduly economically burdensome on Verizon would be to look at whether offering advanced services was expected to significantly reduce Verizon’s rate of return on its common equity investment in Illinois in both absolute and relative terms. The statutory phrase “unduly economically burdensome” suggests that demonstrating that economic losses will occur does not satisfy the company’s burden to demonstrate that it qualifies for a waiver. ICC Staff Ex. 3.1 (Freetly) at 3. Rather, the expectation of economic losses from meeting the requirements must be relatively large for a company to qualify for a waiver. Further, even if advanced services deployment were expected to result in a relatively large reduction in a company’s rate of return on equity, such a reduction would not be “unduly economically burdensome” if that company’s rate of return on common equity was expected to exceed its cost of common equity since the company’s investors would still be earning a fair rate of return.

Staff witness Janice Freetly, utilizing information provided by Verizon, estimated the effect of offering advanced services on Verizon’s jurisdictional return on common equity by calculating the implied rate of return on equity (“ROE”). As Staff explained, implied ROE represents an estimate of Verizon’s earned rate of return on the equity portion of net utility rate base for its Illinois intrastate operations. Staff used implied ROE because Verizon North and South operate in several jurisdictions, and any analysis based on company-wide data would wrongly imply that the profitability of Verizon’s operations in other states should affect the decision for offering advanced services in Illinois. An implied ROE analysis reflects the financial impact on Verizon’s operations in Illinois only. In addition, implied ROE illustrates the effect on Verizon’s ability to provide a fair return to its shareholders on its Illinois investment if required to offer advanced services to its customers in Illinois in accordance with Section 13-517(a).

In analyzing whether Verizon’s implied rate of return, as calculated by Staff, demonstrated that deployment of advanced services reduced Verizon’s implied ROE below a fair rate of return on common equity, Staff made several qualifications. First, the Commission established Verizon’s fair rate of return on common equity at 12.66% in 1994, more than eight years ago. Capital market conditions, such as interest rate levels, have changed since 1994. The risks inherent in Verizon’s operating environment have changed as well. Consequently, according to Staff, a rate of return of 12.66% is extremely generous to Verizon and if a rate case were held today, the rate of return, would in all likelihood, be reduced significantly. Second, Staff’s estimates of the implied rate of return on common equity are a function of Verizon’s estimate of rate base. The larger the rate base, all else being equal, the lower the implied rate of return on

common equity. The smaller the rate base, all else being equal, the higher the implied rate of return on common equity. If Verizon overstated its rate base, then Staff noted that the implied rate of return on common equity would be understated. Third, the short time frame of this proceeding did not permit Staff to investigate the merits of Verizon's rate base estimate. Despite these caveats, Staff used Verizon's last authorized ROE (12.66%) as a proxy for Verizon's fair rate of return on common equity because a more accurate rate of return was not available.

Staff posited that in order to make an informed judgment on the nature of the financial impact that provisioning DSL would impose, two factors must be considered. First, the burden should not be sustained for a long period; otherwise the company will eventually be unable to raise capital on reasonable terms. Hence, to avoid an undue economic burden, the deployment of advanced services should provide the carrier with a fair opportunity to earn a reasonable rate of return over the long-term. Staff points out, however, that what period of time constitutes a "long-term" is open to interpretation. Because Verizon's data only went out to the year 2007, Staff could only extend its analysis to the year 2007. Second, even if a carrier were able to offer advanced services and earn a reasonable rate of return over the long-term, short-term losses, if large enough, might become unduly economically burdensome.

Staff determined that the current yield on A-rated utility bonds could be considered the minimum acceptable ROE before Verizon would be considered as suffering an undue economic burden. Long-term A-rated utility bonds were yielding 6.79% on November 21, 2002. Hence, as long as Verizon's implied ROE does not drop below 6.79% for more than two years, the impact of deploying advanced services should not be viewed as constituting an undue economic burden.

Staff estimated the ROE (implied rate of return on common equity) for the year ending September 2002 based on Verizon's Illinois jurisdictional investment without the costs and revenues associated with the deployment of advanced services and without adjustment to the rate base to remove net pension assets from rate base as required in Docket No. 94-0001. With the costs and revenues associated with the deployment of advanced services, Staff estimated that advanced services deployment would reduce Verizon's implied ROE in 2004, yet, by the year 2007, the implied ROE recovers to within less than 4% of Verizon's last authorized ROE.

Ms. Freetly indicated that based upon this analysis the impact of offering advanced telecommunications services on Verizon's implied ROE would appear to constitute an undue economic burden, subject to the qualifications set forth above and ignoring any grant of a partial waiver under Section 13-517. Although the implied ROEs never fall below the yield on A-rated utility bonds, under this scenario, the deployment of advanced services does not provide Verizon with a fair opportunity to earn a reasonable rate of return over a five year period, which based upon the qualifications stated above, is determined to be the long-term. This scenario, however, represents the incremental revenues and costs associated with deploying advanced services and does not reflect the revenues and costs from the current deployment of advanced services. Staff points

out that it is not appropriate to exclude the effects of the current deployment because then the analysis does not reflect the profitability of the service in full. Therefore, the financial impact on the company may be overstated in this analysis, depending on the profitability of advanced services that Verizon already offers and provides.

With respect to the “adverse economic impact” standard, Staff posited that when incremental costs are greater than incremental revenue, the Commission should assess the “adverse economic impact on users of telecommunications services generally” by assuming that the “company would recover the advanced services revenue shortfall (the extent to which incremental costs exceed the incremental revenue) by including this amount in the revenue requirement for other services.” ICC Staff Ex. 1.0 at 8. Dr. Liu testified that “[o]ne way to assess the magnitude of the ‘adverse economic impact’ under these conditions is to spread any excess of incremental costs over incremental revenue across all of Verizon’s access lines.” ICC Staff Ex. 1.0 at 8. “If the ‘extra’ costs imposed on each access line is ‘significant’ in relation to the level of affordability set by this Commission in the Universal Service Dockets, then [Dr. Liu] would conclude that [the Section] 13-517 requirement would impose ‘adverse economic impact’ on users of telecommunications services provisioned by Verizon.” ICC Staff Ex. 1.0 at 8-9. Dr. Liu pointed out that in this scenario the full cost of compliance needs to be considered because Section 13-517 of the PUA does not propose to establish a ‘universal service fund’ for advanced services, nor does it outline any other forms of external subsidy. Therefore, it is reasonable to conclude that the carriers are expected to absorb the costs of meeting Section 13-517 requirements themselves.

Staff argues that here, the legislative enactment of Section 13-517 of the PUA mandates the provisioning of advanced services by ILECs, and evidences the General Assembly’s determination that the requirement to offer and provide advanced services will serve the public interest. Section 13-517(a) does not directly prescribe a funding mechanism to subsidize ILEC deployment of advanced services. Mr. Trimble’s testimony that Verizon should recover all costs associated with its deployment of mandated advanced services “from either its customer base or from the State of Illinois” suggests that any shortfall resulting from compliance with that mandate should be similarly recovered. Staff urges that Section 13-517 contains no provision for State of Illinois funding of an ILEC’s obligation to provide advanced services under Section 13-517(a). However, the language of Section 13-517 indicates that the costs of compliance with the obligations imposed by Section 13-517(a) may be imposed, subject to certain limitations, on someone other than the users of those services.

According to Staff, it is clear from the language of Section 13-517 that the Legislature anticipates there will be an “adverse economic impact on users of telecommunications services generally” from ILEC compliance with its Section 13-517(a) obligations, having limited a waiver of those obligations to cases where such “adverse economic impact” is “significant.” 220 ILCS 5/13-517 Recovery of an advanced services shortfall from Verizon’s customer base would generally produce an “adverse economic impact on users of telecommunications services generally,” but Section 13-517(b) proscribes such adverse economic impact only if it is “significant.”

Accordingly, Verizon's customer base is a potential additional source of funding for the costs of compliance with Section 13-517(a).

Similarly, it is clear from the language of Section 13-517 that the Legislature anticipates that it will be "economically burdensome" for an ILEC to comply with its Section 13-517(a) obligations, having limited a waiver of those obligations to cases where the costs associated with compliance are "unduly economically burdensome." 220 ILCS 5/13-517 In other words, the Legislature did not anticipate that ILECs would incur none of the costs resulting from compliance with Section 13-517(a), but only that the such cost not be unduly economically burdensome. Absorption of an advanced services shortfall by Verizon itself would generally be "economically burdensome" to the Company, but Section 13-517(b) only provides waiver relief if absorption of such costs would be "unduly economically burdensome." Accordingly, Verizon itself is a potential additional source of funding for the costs of compliance with Section 13-517(a).

Dr. Liu was also of the opinion that Section 13-517 does not provide for a permanent waiver. Section 13-517 states that the Commission shall grant a waiver "to the extent that, and for such duration as, the Commission determines that such waiver" is necessary to avoid the specified conditions. 220 ILCS 5/13-517(b). Dr. Liu explained that there are also policy reasons why the Commission should not consider a permanent Section 13-517 waiver. Technology and other demographic factors change over time. What is true today may not be true five years from now. The factors or evidence that may induce the Commission to grant Verizon a Section 13-517 waiver today may no longer exist several years from now. In other words, even if the company qualifies for a Section 13-517 waiver today, it may not qualify for a waiver in the future. Thus, even if Verizon qualifies for a waiver the Commission should not grant the Company a permanent Section 13-517 waiver. Dr. Liu recommended that the Commission consider a waiver of no more than five years if it decides to grant one.

Staff Witness Dr. Zolnierrek testified that recovery of an advanced services shortfall from Verizon's plain old telephone service ("POTS") customers was not desirable as a matter of policy. Dr. Zolnierrek testified that when the price charged for a service is set above the cost of producing that service, then consumers will not (on the margin) consume the service even when the value they place on the service is greater than the societal value of the inputs needed to produce that service. In general, such an outcome is not economically efficient and may impair the ability of the provider to compete in the market for that service. Alternatively, to the extent that the POTS market in Verizon's territory is not competitive, subsidizing advanced services through charges to POTS customers would amount to an assessment of above cost rates on customers that may be effectively captive customers of Verizon. In Dr. Zolnierrek's opinion, the Commission should not require Verizon to subsidize the deployment of advanced services by recovering the shortfall from its POTS customers or other users of non-advanced services because such an outcome is economically inefficient and inconsistent with sound pro-competitive policy goals.

Dr. Zolnierrek addressed whether his opinion impacted Staff's recommendation regarding how the Commission should determine whether deployment of advanced services would create a significant adverse economic impact on users of telecommunications services generally. Dr. Zolnierrek specifically referenced Dr. Liu's testimony that "[o]ne way to assess the magnitude of the 'adverse economic impact' under these conditions is to spread the excess of incremental costs over incremental revenue across all of Verizon's access lines" and then examine the magnitude of this increase to determine whether it "is 'significant' in relation to the level of affordability set by this Commission (which is \$20.39)." ICC Staff Ex. 4.0 at 6; Staff Ex. 1.0 at 8. Based on his concern that requiring Verizon to subsidize advanced services by recovering any shortfall from POTS or other users of non-advanced services would be economically inefficient and inconsistent with sound pro-competitive policy goals, Dr. Zolnierrek testified that "any requirement that advanced services deployment be funded by increases in POTS or other non-advanced services rates should be considered to impose a significant adverse impact on users of telecommunications services in general." ICC Staff Ex. 4.0 at 6.

However, Dr. Zolnierrek disagreed with Mr. Trimble's contention that Verizon should not be required to deploy advanced services unless the expected revenues from deployment allow recovery of the expected costs. Dr. Zolnierrek explained that Verizon may be required to deploy advanced services in particular areas when deployment to those areas requires the Company to subsidize otherwise unprofitable deployment in the area with supranormal profits earned from the provision of advanced services in other areas. No cross service subsidy would be required in this scenario, and any economic impact would be on users of advanced services rather than users of telecommunications services generally. In addition, as explained above, Section 13-517 contemplates that Verizon may be required to deploy advanced services in particular areas when deployment in those areas does not impose an undue economic burden on the Company. Thus, the expected costs of compliance with Section 13-517(a) could exceed the expected revenues under these scenarios without imposing a significant adverse economic impact on users of telecommunications services generally.

According to Dr. Zolnierrek, Section 13-517(a) imposes some obligation on ILECs in excess of what they would have done as a company concerned only with the direct profitability associated with offering and providing advanced services. Thus, Section 13-517 would limit a carriers ability to decide whether to offer or provide advanced services based on factors other than the direct profitability of offering or providing service, strategic reasons for example, or because of indirect profitability considerations. An ILEC might elect not to deploy otherwise profitable DSL service because customers may switch from its other products (e.g., T1s/DS1s) and reduce the ILECs overall profitability. In Dr. Zolnierrek's opinion, mandating deployment in such circumstances does not in general cause any adverse impact on users of telecommunications services.

Dr. Zolnierrek also addressed the numerous deficiencies identified by Staff with respect to the information submitted by Verizon in its direct testimony. Although Verizon

did provide some further information in response to deficiencies identified by Staff witnesses Mr. Hanson, Dr. Liu, and Ms. Freely, all of the deficiencies they identified were not adequately addressed or remedied. Therefore, although Verizon did address certain Staff concerns, its filing continues to contain significant informational deficiencies.

Verizon contended, for example, that certain data could not be provided because of the informational limitations of its data systems. In this regard, Verizon witness Mr. Trimble stated that “ICC Staff must address the informational limitations that ILEC’s data systems impose on them.” Verizon Ex. 4.0 at 14. Based on his extensive experience with FCC and ICC projects to gather information similar to that now sought by Staff, Dr. Zolnierrek testified that while it is possible for carriers to provide such data doing so is not without cost and may take time. Thus, although Dr. Zolnierrek could not speak directly to what information Verizon does or does not have readily available from its systems, he agreed that Staff cannot discount the possibility that Verizon’s assertions regarding its ability to provide the information requested by Staff within the limited time frame of this proceeding are at least in part valid.

Verizon can obtain a waiver from the requirements of Section 13-517(a) if its requested waiver is necessary in order to avoid imposing an adverse economic impact on users of telecommunications services in general, to avoid imposing an undue economic burden on the Company, and/or to avoid imposing an obligation that is technologically infeasible. According to Dr. Zolnierrek, Verizon has not conclusively proven that any of these criteria are met and that a full waiver of unlimited duration is necessary. Verizon has offered some evidence that with no waiver whatsoever, compliance with the requirements of Section 13-517 might result in an adverse economic impact on users generally. However, that same evidence indicates that Verizon should be able to offer and provide advanced services in significant portions of its service territory with no adverse economic impact on users generally. This evidence would indicate that Verizon has not demonstrated that a full waiver is necessary.

In addition, Verizon’s filing does not provide Staff or the Commission the information necessary to demonstrate conclusively whether its requested waiver is necessary in order to avoid a significant adverse economic impact on users. Finally, Verizon has not argued that deployment is technologically infeasible. Because Verizon has not demonstrated that its requested waiver is warranted according to these criteria, Staff recommends that the Commission deny Verizon’s request for a full waiver from the requirements of Section 13-517(a).

Staff goes on to argue that one problem with Verizon’s case is that the Company does not demonstrate that the requested waiver is “necessary”, which is a legal requirement for granting a waiver. The American Heritage Dictionary (Houghton Mifflin 1985) defines “necessary” as:

1. Absolutely essential; indispensable.
2. Needed to achieve a certain result or effect; requisite: the necessary tools.
- 3.a. Unavoidably

determined by prior conditions or circumstances; inevitable: the necessary results of overindulgence. b. Logically inevitable. 4. Required by obligation, compulsion, or convention: made the necessary apologies.

Given the context and connection in which the word necessary is used in Section 13-517, as well as the common meaning of that term as indicated in the above-definition, it is not enough to show that the requested waiver is one way to avoid the relied-upon condition or that it would be a convenient way to avoid the relied-upon condition. Rather, the requested waiver must be absolutely essential or indispensable or logically unavoidable such that the relied upon conditions cannot be reasonably avoided through a more limited waiver. Staff submits that Verizon has not made this showing.

Staff's analysis of Verizon's data demonstrates that Verizon can comply with Section 13-517(a) for a substantial number of the exchanges and customers for which it requests a waiver without experiencing or being subjected to any of the statutory waiver conditions relied upon for the waiver request. Thus, Staff's analysis shows that Verizon can avoid the statutory conditions relied upon for a waiver through a more limited waiver. For that reason, a full waiver is not allowable under the applicable legal standard. Therefore, Staff recommends that the Commission deny a full waiver for all areas where DSL is not currently deployed for the above-stated reasons.

Although Verizon has failed (i) to remedy the informational deficiencies with its filing and (ii) to demonstrate that its requested waiver is necessary, Staff does not recommend that the Commission completely disregard the information submitted by Verizon in this proceeding. The information submitted by Verizon suggests that deployment in a number of its exchanges may generate costs in excess, potentially far in excess, of revenues that are expected from deployment. For certain of these exchanges it is highly probable in Staff's estimation that this conclusion will not change even when Verizon corrects the deficiencies in its filing. Dr. Zolnierrek recommended that the Commission consider the potential harm to users of telecommunications services in these and other exchanges if Verizon is not relieved of its Section 13-517(a) obligations to offer or provide advanced services in these exchanges.

While Verizon has not requested a partial waiver in the event that its requested waiver is denied, Staff recommends that the Commission consider granting Verizon a limited duration extension for certain of its exchanges. Dr. Zolnierrek recommended that the Commission grant Verizon a one year extension of its Section 13-517(a) requirements for that set of exchanges for which Verizon cannot -- according to the Staff exchange level analysis -- deploy advanced services without potentially causing a significant adverse impact on users of telecommunications services. These exchanges are identified in Staff Late Filed Exhibit 2. Dr. Zolnierrek recommended that the Commission implement this limited duration extension in order to ensure that users of telecommunications services in these Verizon service areas and other Verizon service areas do not suffer any adverse economic impact from deployment. The information presented by Verizon, though it suffers defects, indicates that full deployment as

required by Section 13-517(a) could have a significant adverse economic impact on users of telecommunications services.

Staff recommends that the Commission, based on the data submitted by Verizon, extend Verizon's obligation to offer or provide advanced services in those exchanges identified by Staff Witness Hanson from 2005 to 2006. This will provide Verizon six months to work with Staff and gather information that will remedy the defects in its filing before it resubmits a waiver request, and will afford the Commission its six-month statutory review period to review the updated request. This one-year period will obviate the need for the Company to immediately begin deployment of advanced services in those areas where such deployment has a reasonable probability of leading to a significant adverse impact on the users of telecommunications services in Verizon's territories.

To ensure that consumers receive advanced services in exchanges where deployment to Verizon's customers is reasonably unlikely to lead to a significant adverse impact on users of telecommunications services, the Commission should provide no waiver for those exchanges at this time. Staff recommends that the Commission should, at a minimum, require Verizon to meet its Section 13-517(a) deployment obligations in that set of exchanges where Staff's exchange level analysis of Verizon's information shows the collective revenues from deployment would exceed the collective costs. This recommendation is conservative in two respects. First, Staff expects that should Verizon remedy the defects in its filing, that the set of exchanges for which the costs of deployment are in excess of the revenues from deployment will decrease. Second, Staff's recommendation for the short-term extension is based on a "break even" analysis, which does not require Verizon to deploy to exchanges that would collectively yield an expected revenue shortfall, or to raise its current advanced services rates. When the Commission has all the information that is required to make an informed decision, it may determine that deployment to an expanded set of exchanges will not have a significant adverse economic impact on users of telecommunications services generally. Such considerations will need to be reviewed when Verizon returns to the Commission for any additional waiver.

Staff Witness Mark A. Hanson, an Economic Analyst in the Rate Section of the Telecommunications Division of the Commission, also analyzed Verizon's cost estimates submitted in support of its request for a waiver pursuant to Section 13-517(b) of the PUA to determine whether a waiver of limited duration should apply. Mr. Hanson disagreed with many aspects of Verizon's analysis and in particular did not agree with the Company estimate of the costs it claimed it would incur to comply with the requirements of Section 13-517(a). Mr. Hanson concluded in his direct testimony that he could not support Verizon's waiver requests in view of the problems with its cost estimates.

Mr. Hanson explained that Verizon witness Dennis Trimble testified that it would cost the Company a total of approximately \$329 million to provision advanced

telecommunications services to 80% of its customers based upon Verizon's total cost estimate of three major components:

Outside Plant investment	\$255 Million
Interoffice Transport Costs	\$ 41 Million
<u>Advanced Data Network Costs</u>	<u>\$ 33 Million</u>
Total	\$329 Million

ICC Staff Ex. 2.0 at 5. Mr. Hanson's analysis revealed that Verizon's estimate of the costs to deploy DSL service to 80% of its customers was overstated. ICC Staff Ex. 2.0 at 5-6.

Mr. Hanson supported his conclusion by arguing that Verizon's costs were not derived from an analysis of each of its exchanges. Instead, Verizon analyzed twenty of its Illinois exchanges to estimate the cost of providing DSL service in those exchanges. Those twenty exchanges were divided into six groups or types (based on the number of access lines), and the estimated costs were totaled and then averaged. The twenty exchanges were grouped as follows:

- Group 1 -- 13 exchanges with less than 1,000 access lines in each exchange;
- Group 2 -- 3 exchanges with less than 1,500 access lines in each exchange;
- Group 3 -- 1 exchange with 1,973 lines (less than 2,000 lines);
- Group 4 -- 1 exchange with 4,742 lines (less than 5,000 lines);
- Group 5 -- 1 exchange with 8,839 lines (less than 10,000 lines); and
- Group 6 -- 1 exchange with 29,715 lines (10,000 or more lines).

ICC Staff Ex. 2.0 at 6.

According to Mr. Hanson, Verizon simply added the outside plant costs for each of the 13 Group 1 sample exchanges and divided by 13 (the number of exchanges) to determine that the average outside plant cost for the sample. Verizon then determined the outside plant costs for the exchanges with less than 1,000 lines by applying the average cost for the Group 1 sample to each such exchange. Verizon used the same methodology for its larger exchanges, except that no averaging was performed for Groups 3 through 6 because those sample Groups each consisted of a single exchange.

Mr. Hanson identified several problems with Verizon's methodology. First, Verizon used samples that were relatively small, making the reliability of the resulting estimates uncertain. Moreover, to the extent small samples are used to estimate large exchange groups, there is inherently more of a potential for overall estimation inaccuracies, particularly in light of the extreme variation in the cost estimates of providing service between exchanges. For example, Verizon used 3 data points to represent a group of 94 communities and used one data point to represent groups of 19 and 33 communities. There were also extreme variations within Verizon's samples. For example, the highest cost estimate for Group 1 was 268 times the lowest cost estimate

Mr. Hanson also questioned Verizon's use of average or mean costs, as opposed to the median cost figure, given the variety of characteristics in its sample. Mr. Hanson provided an example to demonstrate this principle. Suppose a researcher wishes to obtain the salary levels in Chicago. Obviously, to obtain the most accurate results possible, the researcher would have to survey every resident in the city. However, that is not practical for the researcher. Thus, the researcher decides that she will determine what salary levels are in Chicago by walking down the street and asking the next five people she sees about salary levels. The researcher stops four people. Those four people have salaries of \$40,000, \$25,000, \$60,000, and \$75,000 respectively. The researcher then stops the fifth and final person in the study. This person turns out to be baseball star Sammy Sosa. When asked by the researcher what his salary is, Mr. Sosa replies that he makes \$15 million a year.

Using this small sample, the researcher would determine that the average salary for a Chicago resident is \$3,040,000 a year. However, this researcher realizes enough about the nature of salary distribution to recognize the average is not providing an accurate measure of salary levels in the city. Therefore, she decides to use the median of the sample, i.e. \$60,000 as her measure of salary levels in Chicago. In this situation, the use of the median provides a more accurate measure than the use of the mean or average. ICC Staff Ex. 2.0 at 8-9.

Mr. Hanson concluded that the very limited samples upon which Verizon depends to make its cost estimates can lead to estimates that may seriously misestimate the actual cost of providing the service. However, Mr. Hanson also recognized that it would not be realistic for Verizon to perform a cost analysis for each of its 413 exchanges. Therefore, Mr. Hanson recommend that Verizon conduct a new study with a least three data points in each of its groupings.

Another problem with Verizon's estimate of the cost to provide outside plant investment for DSL service is that it includes costs (based on the average per exchange cost for the Group) for areas that already have such services. Mr. Hanson observed that although Verizon Exhibit DBT-1 shows that 9 of the 13 Group 6 exchanges already have DSL capability, Verizon included outside plant costs for each of the 13 Group 6 exchanges. Therefore, even assuming the estimate based on one data point is valid for the whole group, the multiplier should be 4 rather than 13. That would reduce outside plant investment for the Group 6 exchanges by approximately \$22 million from \$32,328,205 to \$9,947,140. Similar problems exist in the other groups, which further indicate that Verizon's estimates are unreliable. Thus, Mr. Hanson concluded that Verizon's estimated costs of providing service to those exchanges cannot be used to justify its waiver request.

Mr. Hanson also addressed Verizon's assertion that many of Verizon's exchanges have a relatively low number of customers per switch. Mr. Hanson testified that this information does not support Verizon's waiver request based on his examination of Verizon's data. Mr. Hanson produced a table showing the OSP cost and

the switched lines per square mile for the exchanges constituting the Group 1 sample indicating only a .150568 correlation between the switched lines per square mile and total costs. It also showed only a .022698 r-squared between outside plant investment and lines per square mile. The statistic in this instance says that only 2.268% of the variation in outside plant investment is caused by variation in switched lines per square mile. This indicates that there is a very minor relationship between outside plant costs and lines per square mile, at least for this group of exchanges.

Mr. Hanson also observed that Verizon's cost study presents an estimate of the cost to make DSL available to 80% of its customers in each exchange. Consistent with Staff witness Dr. Liu, Mr. Hanson explained that Verizon has not undertaken its cost analysis in a fashion that would result in serving 80% of its customers in the most efficient manner. In other words, Verizon's cost estimate does not attempt to determine the least cost means to make advanced telecommunications available to 80% of its customers overall. Thus, Mr. Hanson concluded that Verizon's approach has the effect of producing overstated costs from a least-cost perspective.

According to Mr. Hanson, Section 13-517(a) requires that an ILEC offer or provide advanced telecommunications services to not less than 80% of its customers, and does not require ILEC's to reach the 80% requirement in any particular manner. The General Assembly has found that the "health, welfare and prosperity of all Illinois citizens require the provision of adequate, efficient, reliable, environmentally safe and least-cost public utility services at prices which accurately reflect the long-term cost of such services and which are equitable to all citizens." 220 ILCS 5/1-102. Section 8-401 of the PUA further provides that "[e]very public utility subject to this Act shall provide service and facilities which are in all respects adequate, efficient, reliable and environmentally safe and which, consistent with these obligations, constitute the least-cost means of meeting the utility's service obligations." 220 ILCS 5/8-401 These statutory provisions make clear that all public utilities have the obligation to provide services on a least cost basis, consistent with its other obligations. Nothing in Section 13-517 diminishes or supercedes this obligation. Accordingly, Verizon's waiver request must be based on costs that are consistent with its obligations to provide required services on a least cost basis.

In view of all of the above, Mr. Hanson recommended in his direct testimony that Verizon adopt a sampling methodology that more accurately represents costs (as a general proposition) and a least cost approach (as a specific proposition) to provision outside plant for DSL services. He further recommended that Verizon produce cost estimates that omit costs for exchanges that already have the capability to provide advanced telecommunications services. Mr. Hanson then developed alternative costs in his direct testimony to account for the most blatant flaws in Verizon's analysis, which he found to be Verizon's lack of recognition of exchanges that could currently support DSL and the fact that Verizon did not attempt to define the least cost manner in which it could serve 80% of its customers in total, rather than examining the cost of serving 80% of the customers in each exchange. Mr. Hanson assumed a 3-year phase-in with the plant being in service on January 1, 2005, consistent with Section 13-517(a).

Mr. Hanson also adduced testimony in response to analyses offered by Verizon witness Dennis Trimble in his rebuttal testimony. These analyses principally address revenue shortfalls Verizon contends it will incur to comply with the requirements of Section 13-517. Mr. Trimble's rebuttal testimony acknowledged that some of Mr. Hanson's criticisms of the method by which Verizon had generated its original estimate of outside plant investment had merit. Accordingly, Verizon's submitted revised estimate of outside plant costs based upon cost estimates specific to each central office or exchange instead of utilizing a sampling approach. Verizon provided these revised cost estimates to Staff via an updated response to a Staff Data Request. Despite the fact that Verizon purportedly revised its methodology, Verizon's estimate of total costs did not change greatly, coming in at around 90% of the original figure.

Although Mr. Hanson found Verizon's new estimate of outside plant costs was improved (based primarily upon an improved sampling methodology), he continued to find some deficiencies in Verizon's cost estimate. Mr. Hanson expressed concerns regarding Verizon's revenue estimates, testifying that Verizon may be understating the number of customers who will use DSL services. Further, Mr. Hanson explained that forecasts of the percentage of customers who elect to use or adopt advanced telecommunications services could be very volatile. At the same time, assumptions made regarding the penetration of advanced services have a critical impact on any analysis of whether expected revenues meet or exceed expected costs. Demand for advanced telecommunications services could significantly increase if a new program or application for broadband services was developed, thereby increasing revenues without increasing costs.

Mr. Hanson also pointed out that Verizon did not address certain deficiencies in its data as identified in the testimony of Staff witness Dr. Liu. Those deficiencies, if unremedied, could have a meaningful impact on Verizon's cost estimates. Mr. Hanson also testified that he still had some qualms about the quality of Verizon's data, particularly because the data was still not very detailed and Verizon did not perform engineering analyses for each of their areas. Rather, Verizon's revised estimates provide "top-level" planning estimates.

Further, Mr. Hanson was of the opinion that because Verizon's cost and demand estimates are based on today's technology, they should only be viewed as support for a waiver of limited duration, particularly because forecasts of adoption rates for advanced telecommunications technologies are inherently very fluid and a doubling of the take rate of advanced telecommunications services would make offering the service profitable to Verizon, even though a minority of customers would still be using the service. As is the case with adoption rates, alternate low cost technologies may develop in the near term which would significantly lower the cost of providing such services. Accordingly, Verizon's data can not establish that a long term waiver is necessary.

Mr. Hanson concluded in his rebuttal testimony that although the Company's information is not adequate to perform a complete analysis, the data currently available

suggests that there may be an adverse economic impact in the short run if the Company were to ubiquitously deploy advanced telecommunications services to 80% of its customers with no waiver whatsoever. However, this negative impact may be transitory and is very sensitive to the adoption rate of advanced telecommunications services. Therefore, in Mr. Hanson's opinion, this information did not demonstrate the need for a permanent waiver from the requirements of Section 13-517(a). The highest likely adverse economic impacts are in 2004 and 2005. By 2006, the adverse economic impact is lessened considerably. Additionally, Mr. Hanson testified that Verizon would break even in 2006 if only three per cent more customers opted to take those services rather than the number Verizon forecasts. Accordingly, in Mr. Hanson's opinion, this information does not adequately demonstrate satisfaction of the statutory conditions required to grant Verizon a permanent waiver for all exchanges.

Although Verizon only analyzed its data on an aggregate basis, Mr. Hanson performed an analysis of Verizon's data at the exchange level. As noted above, Verizon's revised cost estimate was based on outside plant investment numbers for each of its exchanges. Mr. Hanson analyzed Verizon's exchange level data to determine the impact of providing DSL services in each of those exchanges. Mr. Hanson explained that he assigned costs to each exchange based on Verizon's exchange level data or, where such data was not available, on an access line allocation basis. He then multiplied the exchange specific costs by Verizon's annual charge factor to determine the annual cost of providing advanced services in the particular exchange. To determine the projected number of customers who would take the service in each exchange, Mr. Hanson took the number of residential access lines in each exchange from Verizon Exhibit DBT-1, multiplied that number by .8 to reflect 80% coverage, then multiplied that result by Verizon's assumed penetration rate. To determine expected annual revenues for each exchange, Mr. Hanson multiplied the number of projected customers by \$480. From this data, Mr. Hanson calculated a ratio of revenue to cost for each exchange.

Mr. Hanson testified that this analysis revealed that 136 of Verizon's 413 exchanges have projected revenues greater than costs (i.e., exchanges where revenues were at least 100% of costs). Mr. Hanson also testified that his analysis disclosed that Verizon's revenue would exceed its costs of providing service for those exchanges (as a group) once the service is fully adopted. Mr. Hanson then performed an analysis to determine if, according to Verizon's data, Verizon could also deploy DSL services to some of the exchanges with less than a 100% revenue ratio and still break even (i.e. a group of exchanges including all of the individual exchanges where revenues exceed costs and some of the individual exchanges where costs are marginally greater than revenues). Mr. Hanson determined that, according to Verizon's data, DSL could be deployed to the group of exchanges with a revenue ratio of 58% and above and still break even. This group of exchanges consisted of 240 of Verizon's 413 exchanges with 412,042 residential access lines. Mr. Hanson pointed out that Verizon's annual charge factor includes a component for return, so the Company is making a return on its investment when his analysis shows a break even scenario. Because Verizon's data shows that the Company would recover its costs, including a

return on its investment, there would be no economic burden on the Company or impairment of the Company's financial condition if the Commission were to base any potential waiver on this set of exchanges.

Mr. Hanson also testified that the Commission might elect to grant a temporary extension from compliance with the requirements of Section 13-517(a) for the 173 exchanges where revenues were less than 58% of costs (i.e., the most unprofitable exchanges). In sum, the data suggests that deployment of DSL in the most unprofitable exchanges may impose a significant adverse economic impact on telecommunications users generally, and a one year extension will allow the Company to remedy its data deficiencies and present sufficient information to demonstrate the need for a waiver of longer duration. The 173 exchanges described above were listed in Attachment 3 to Mr. Hanson's testimony.

Mr. Hanson also filed supplemental rebuttal testimony to address certain new information presented by Verizon witness Dennis Trimble in his surrebuttal testimony. Verizon's analysis of costs and revenues was based on an incremental approach – comparing the incremental costs (the additional costs to go from the current DSL deployment to 80% deployment) to the incremental revenues (the revenues associated with additional potential customers gained from the additional deployment). Mr. Hanson originally adjusted Verizon's cost estimate because it appeared to include cost for communities where DSL had already been deployed. Mr. Hanson reversed that adjustment based on Verizon's surrebuttal testimony that the costs for those communities was for additional deployment in those communities beyond the current deployment. Similarly, Mr. Hanson's adjustments to Verizon's revenue calculation relied on customer numbers that included existing (as opposed to new) potential DSL customers. Thus, Mr. Hanson revised his revenue adjustment of Verizon's calculation to only reflect additional potential DSL customers gained from the additional deployment. Mr. Hanson's revised analysis showed a larger shortfall than he had originally calculated. The per line shortfall, expressed as a percentage of the monthly residential network access line charge, peaked at 21.58% for 2005 and fell to 16.14% for 2007. However, Mr. Hanson cautioned that -- in his opinion -- Verizon's incremental analysis overstates the impact of compliance with the requirements of Section 13-517 because it does not take into account the revenues and costs associated with Verizon's existing DSL deployment.

During cross examination, Mr. Hanson acknowledge that his revised numbers included revenues for residential lines only, but included costs for both residential and business lines. This information prompted the Administrative Law Judge ("ALJ") to question whether Staff needed to correct its calculation to avoid a mismatch of numbers and information. The ALJ indicated that if Staff had the information to update its numbers, and if those updated numbers have an impact on Staff's opinion and recommendation, then an updated exhibit should be provided. Staff determined that information to update its analyses was available, and Staff filed Staff's Motion For Admission Of Late Filed Exhibits ("Motion") on February 25, 2003. Staff's Motion was not objected to by any party,

and Staff Late Filed Exhibits 1, 2, 3, 4, 5 and 6 were admitted into evidence on March 10, 2003.

Staff Late Filed Exhibit 1 is an update of Attachment 1 to ICC Staff Ex. 2.2. This exhibit reflects Mr. Hanson's analysis of Verizon's presentation of the estimated incremental costs and incremental revenues to deploy DSL, on a least cost basis, so as to offer DSL Transport to 80% of all of Verizon's customers. Staff Late Filed Exhibit 1 used Verizon's rebuttal estimate of the additional potential DSL customers (residential and business) from the incremental deployment of DSL services. This ensured a match of revenues and costs by allowing the calculation of incremental revenues for business and residential customers to be compared to the incremental costs for business and residential customers.

Staff Late Filed Exhibit 1 also uses revised penetration rates to reflect phased deployment using Staff's phased deployment assumption of 25% for year one, an additional 50% for year two and an additional 25% for year three. Because of the phased deployment, the revenue projections do not reach the maximum projected penetration levels by the end of the five year presentation. Thus, Staff Late Filed Exhibit 1 adds an additional column showing the annual revenues and costs assuming the service is fully adopted (i.e., full penetration rates achieved). Staff Late Filed Exhibit 1 also provides (i) the annual and cumulative shortfall resulting from the incremental deployment of DSL to meet the 80% requirement and (ii) the per access line amount of the annual shortfall if recovered over a comparable 12 month period based on the total number of access lines.

The updated analysis reflected in Staff Late Filed Exhibit 1 increased the estimated cumulative shortfall at year end 2007 (associated with the incremental ubiquitous deployment of advanced telecommunications services to 80% of Verizon's customers -- i.e., with no waiver whatsoever) by approximately 4%. The changes resulting from Mr. Hanson's revised analysis reflected in Staff Late Filed Exhibit 1 are relatively minor, and do not change any of Staff's positions previously expressed. Also, as was expressed in Mr. Hanson's rebuttal testimony, Staff continues to question Verizon's numbers for the reasons previously identified. Staff also identified some apparent inconsistencies with Verizon's data in its Motion.

The same revisions described in Staff Late Filed Exhibit 1 resulted in revisions to Mr. Hanson's exchange level analysis discussed previously. These revisions are contained in Staff Late Filed Exhibit 2, which identifies a group of exchanges consisting of all profitable exchanges and the least unprofitable exchanges for which overall estimated revenues exceed overall estimated costs. These revisions are also reflected in Staff Late Filed Exhibit 4 (which used the same data as Staff Late Filed Exhibit 2 but identifies only profitable exchanges) and Staff Late Filed Exhibit 6 (which presents the same analysis as Staff Late Filed Exhibit 2 using cost figures not based on least-cost deployment). The exchange specific line, customer, investment, cost and revenue information contained in Staff Late Filed Exhibit 2 corresponds to the revised summary numbers in Staff Late Filed Exhibit 1, and is based on the same data sources and

assumptions used in Staff Late Filed Exhibit 1. Staff notes that its allocation of the lines, customers, costs, and revenues to the specific exchanges in Staff Late Filed Exhibits 2, 4 and 6 was not challenged by Verizon.

The revised analysis reflected in Staff Late Filed Exhibit 2 shows that Verizon could, according to its own data, deploy DSL services to some of the exchanges with less than a 100% revenue ratio and still break even. The analysis shows further that DSL could be deployed to the group of exchanges with a revenue ratio of 45% and above and still break even. This group consisted of 270 of Verizon's 413 exchanges with 376,038 residential and business customers. As pointed out in Mr. Hanson's rebuttal testimony, Verizon's annual charge factor includes a component for return, so the Company is making a return on its investment even in a "break even" analysis. According to Staff, its analysis of Verizon's data shows that the Company would recover its costs, including a return on its investment if it were required to serve the 270 exchanges without any impairment of the Company's financial condition.

Staff Late Filed Exhibit 2 provides an updated list of the exchanges for which Staff recommends a one-year extension of the requirement to comply with Section 13-517(a). Staff's updated recommendation for a temporary extension from compliance with the requirements of Section 13-517(a) is for the 107 exchanges where revenues were less than 45% of costs (i.e., the most unprofitable exchanges). The 107 exchanges described above are listed under the column labeled "Extension Areas" in Staff Late Filed Exhibit 2.

#### **D. Mt. Zion's Position**

Mt. Zion opposes granting the relief sought by Verizon based upon its apparent belief that the only way in which its citizens will receive low cost DSL service from the company is through the legislative mandate. Mt. Zion urges Verizon to transfer the city into the service area of the telecommunications provider offering service to its neighboring cities of Decatur and Forsythe, where low cost DSL service is currently available.

#### **E. Verizon's Replies**

Verizon begins by addressing its request for certification and asserting that Staff and the AG failed to rebut the fact that Verizon's intrastate high speed data services, which support speeds in excess of 200 kilo-bits per second to more than 80% of Verizon's customers, are advanced services under Section 13-517 of the Act. Instead, according to Verizon, they attempt to push the Commission to exceed its jurisdiction by ordering Verizon to deploy interstate DSL transport service ("DSL TS") in exchanges where such service cannot stand on its own, thereby requiring other services or Verizon shareholders to subsidize it. Verizon asserts that neither the record nor the law supports this proposal.

Rather, according to Verizon, the record demonstrates that Verizon's current intrastate advanced services offerings meet the requirements set forth in the plain language of Section 13-517. Specifically, these services are capable of supporting, in at least one direction a speed in excess of 200 kilobits per second ("kbps"). According to Verizon, the record also demonstrates that Verizon offers existing advanced services that provide the required bandwidth in all of its exchanges. Accordingly, no further action is required on the part of Verizon to satisfy Section 13-517.

If the Commission does not agree with Verizon's request for certification, Verizon asserts it should be granted a partial waiver of the Section 13-517 requirements because the record overwhelmingly demonstrates that given the rural nature of its service territory, the low customer demand for DSL TS, and the costs to deploy such services, a mandated deployment in the areas where Verizon seeks a waiver (the "Waiver Areas") will result in significant revenue shortfalls and constitute an undue economic burden pursuant to Section 13-517. Moreover, such a mandated deployment would require significant subsidies and, as such, would also constitute a significant adverse economic impact on users of telecommunications services pursuant to Section 13-517 of the Act. In contrast, Verizon's proposal to introduce a DSL TS Bona Fide Request ("BFR") process in the Waiver Areas would allow for the economically efficient introduction and expansion of the service in those areas.

Verizon goes to argue that the respective Initial Briefs of Staff and the AG fail to provide any persuasive arguments that undercut Verizon's position. According to Verizon, the briefs are significant not for what they contain, but rather are notable for what they fail to state. Verizon cites a number of omissions that Verizon finds material. As an example, Verizon states that Staff and the AG never discuss the fact that Verizon's intrastate advanced services offerings fit squarely within the plain language requirements of Section 13-517. Rather than consider the plain language of the Act, they resort to creating ambiguity where none exists, by creating novel definitions of commonly understood terms, and offering unpersuasive references to legislative history.

In addition, Verizon states that Staff and the AG failed to recognize that the Federal Communication Commission ("FCC") has determined that DSL TS is an interstate service and Verizon has tariffs on file with the FCC for the provision of such service. As such, their position that the Commission can mandate the deployment of this interstate service is illegal.

Verizon goes on to assert that Staff and the AG ignore Verizon's actual penetration rates for DSL TS even though Staff has had these figures since October 2002. The record demonstrates that Verizon is experiencing a penetration rate in areas where DSL TS has been deployed for three or more years much lower than the 17% penetration rate utilized in their calculation, a rate that was utilized by Verizon in its case only for the purpose of illustrating that even with the most optimistic of scenarios, deployment of DSL TS in the Waiver Areas is not financially viable.

In addition, neither Staff nor the AG discuss the relevance of Section 13-103 of the Act, which requires that investment in advanced services must be prudent. Furthermore, the General Assembly defined the context in which such investment should be encouraged stating the importance of “effective and sustained competition.” 220 ILCS 5/13-103. Neither party ever reconciles its respective positions for subsidized DSL TS with the legislature’s clear pro-competitive guidelines nor addresses the fact that other alternatives to advanced services already are available in some of the Waiver Areas. Moreover, neither addresses the fact that new technologies are being developed and are likely to emerge in the near future. According to Verizon these alternative advanced services options will place downward pressure on Verizon’s DSL TS penetration rates.

Neither Staff nor the AG ever meaningfully discuss Verizon’s proposed Bona Fide Request (“BFR”) proposal. The record demonstrates that this process will accommodate what the market actually desires, not what various groups believe the public wants, and will ensure there is no undue economic burden on Verizon and its customers.

In determining whether deployment of DSL TS causes an undue economic burden pursuant to Section 13-517, Staff turns a blind-eye to whether the investment itself is prudent. This position is unreasonable and inconsistent with the General Assembly’s clear mandate regarding the “. . . development of and prudent investment in advanced telecommunications services . . . .” 220 ILCS 5/13-517

In sum, according to Verizon, neither Staff nor the AG discuss the consequences associated with a mandated deployment of DSL TS. What is particularly distressing about Staff’s position is that they acknowledge that “technology and other demographic factors” may be different in five years and that it is “possible” that DSL TS will become obsolete five years from now. (Staff Ex. 1.0, Liu Dir., pp.9-10; Tr. at 341). With such change likely to occur, it is unreasonable for the Commission to mandate a deployment of DSL TS, especially when the record demonstrates that: 1) it is not financially viable in the Waiver Areas; 2) substantial revenue shortfalls will result even assuming a penetration rate of 17% (which is much more than Verizon is actually experiencing); and 3) other advanced services alternatives already exist in the Waiver Areas. Taken together, these factors unequivocally support Verizon’s alternative waiver request.

In terms of Staff’s argument that Verizon’s certification request is legally improper because it fails to rely on the plain meaning of the Act, Verizon first asserts that Staff could not rely on the language of the statute because the plain language of Section 13-517 unequivocally supports Verizon’s position. Thus, Staff’s only choice in promoting its agenda is to inject ambiguity into this Section where none exists. For example, Staff brings the issue of price into the analysis; however, nowhere in Section 13-517 is the price of any advanced services ever mentioned. Indeed, if the General Assembly had intended for price to be a consideration in Section 13-517, it would have included it. The Act does not and Staff’s arguments resting on price are without merit.

Verizon notes that in passing Section 13-517, The General Assembly did not specifically mandate any particular service or technology, nor did it exclude any services or technologies that already are offered by ILECs. Further, there is no mention of price being a consideration in Section 13-517. Despite the clear language in the Section, Staff attempts to inject these extraneous factors into the discussion of whether Verizon meets the requirements of Section 13-517. However, Staff's introduction of new factors such as service type and price serve to change the statute. Staff's interpretation is improper because if the legislature had intended for price, particular technologies, or certain services to be factors in the Commission's analysis, it would have so stated. Indeed, Staff's position on certification is entirely inconsistent with another discussion of statutory construction found in Section II.A. of its Initial Brief. In the latter section of its Brief, Staff states that legislative intent should be sought primarily from the language of the statute because the language of the statute is the best evidence of legislative intent, and provides the best means of deciphering it. Moreover, Staff states that if the legislature's intent can be determined from the plain language of the statute, that intent must be given effect, without further resort to other aids to statutory construction. (Staff Init. Br., p. 11)

Verizon asserts that, while Staff provides a correct analysis of statutory construction principles, proper application of those principles is nowhere to be found when Staff discusses the certification issue. Verizon argues that, given the clear and unambiguous language of Section 13-517, Staff's argument that the current interstate advanced services offerings of Verizon predate the Act is of no consequence, but is, rather, an attempt to supply omissions, remedy defects, or add exceptions and limitations to the statute's application, regardless of its opinion regarding the desirability of the results of the statute's operation. According to Verizon, if the legislature intended to mandate DSL TS, exclude existing advanced services offerings, or take price into account, it would have so stated. As such, Staff's criticisms of Verizon's interpretation of Section 13-517 fail for the very reasons that Staff cites in Section II.A of its Initial Brief.

Verizon asserts that Staff's contention that this controversy is not ripe for Commission review because there is no enforcement action pending, threatened or contemplated makes no sense. Verizon asserts that Staff's position that no certification request can be initiated until after the Commission begins an enforcement proceeding in 2005 is unreasonable, contrary to the public interest, and exhibits a general lack of understanding regarding the investment and planning required to deploy any new advanced services. Indeed, Verizon posits that it would be irresponsible for it to wait until 2005 to have these issues resolved.

Under Staff's logic, an ILEC must wait until January 1, 2005, and until there is a Commission initiated enforcement proceeding before it can file for a waiver or certification. At that point, after perhaps months-long proceeding, there would finally be a Commission Order stating whether the ILEC would need to begin to take steps to deploy other advanced services. Moreover, under Staff's proposal, Verizon could be subject to injunctive relief, fines, or penalties if it decided to wait for a Commission

enforcement proceeding and was found to be in violation of the Act. 220 ILCS 5/13-303.5; 13-304; 13-305. Verizon finds Staff's position unreasonable.

Staff witness Liu unequivocally conceded the importance of having this controversy decided now rather than sometime after January 1, 2005:

Q. Well, let me ask a hypothetical. This is strictly from a policy point of view. Lets say for the sake of argument, for the sake of hypothetical, that Verizon does nothing in terms of coming to the Commission to seek a certificate, certification. And on January 1, 2005, we believe we are meeting the Act. And Staff believes, as it is your articulated position, that we are not. Don't you think that it is prudent to seek such a resolution now rather than wait until the January 1, 2005, date?

A. Do you mean resolution to decide whether, which position is right?

Q. Resolution as to whether we are currently meeting the requirements of 13-517?

A. Yes I would think so.

(Tr. at 321-322).

According to Verizon, Staff ignores the consequences of its position. Staff fails to consider the time required for planning and construction, as well as the costs involved with the deployment of DSL TS into new areas. Aside from Dr. Liu's statement on cross-examination, Staff's position is oblivious to these real concerns that affect not only Verizon, but its customers as well.

Furthermore, Staff's mischaracterization of Verizon's request as a declaratory ruling is a red herring. Verizon is not seeking a declaratory ruling. Staff cites no authority supporting the proposition that the Commission cannot decide the entire controversy before it in the instant proceeding. Stated simply, there is no law precluding resolution of the issues presented to the Commission. Verizon has made a record for all of its advanced services offerings—both intrastate and interstate—in its combined certification/waiver request. It is judicially efficient, and perfectly legal, for the Commission to weigh the facts and to rule that Verizon's current offerings satisfy the Act.

Accordingly, the Commission should reject Staff's legally deficient position. Verizon requests certification now, rather than sometime after January 1, 2005, that Verizon's current intrastate advanced services offerings meet the requirements of Section 13-517 of the Act.

Staff's reliance on its proposed definitions for the terms "offer" and "provide" found in Section 13-517 is legally incorrect and factually inconsistent. Foregoing any legal analysis, Staff provides a long summary of Staff witness Liu's novel theory that the legislature did not intend the common meanings of "offer" and "provide" to apply in Section 13-517. Verizon argues first that Staff provides no basis whatsoever for the Commission to depart from the common definitions of these terms. This fact alone is

sufficient to reject Staff's claim. Rather, Staff offers the non-legal opinion of its witness to propose alternative definitions for these commonly understood terms. Verizon asserts that Staff's proposal is baseless and that the Commission must look at the plain meanings of these terms and how they are used in other sections of the Act. For example, simultaneous with the enactment of Section 13-517, the legislature also amended the definitions of several commonly used terms. See e.g. 220 ILCS 5/13-202.5, 5/13-220. The Legislature chose not to define the terms "offer" and "provide." Accordingly, such terms must be given their commonly understood meaning. The fact that it takes Staff multiple pages to define these simple and commonly used terms should be a clear indication to the Commission that something is amiss.

Finally, Staff's new definitions for "offer" and "provide" collapse under the weight of their complexity. Verizon asserts that it was evident during cross examination that Staff witness Liu did not realize that Verizon's DSL TS service is not marketed to the public, but rather is a service provided to ISPs. As such, her definition of "offer," which required that the product actually be marketed to a particular segment of the retail market, instantly lost merit.

Staff's Initial Brief attempts to resuscitate its position, but to no avail. Staff states there that:

In response to Staff data requests, Verizon stated that it currently sells DSL transport services "primarily to ISPs who then package DSL with their internet service offerings." (ICC Staff Ex. 1.0 at 28). Dr. Liu testified that DSL transport services in an exchange would be of no value to the buyers if no ISP is willing to provide DSL internet access in that exchange (because DSL (transport) services are primarily used in conjunction with internet access). (ICC Staff Ex. 1.0 at 28). Dr. Liu noted that Verizon did not indicate in its direct testimony whether it had signed up with an ISP in its DSL deployed exchanges. (ICC Staff Ex. 1.0 at 28). Dr. Liu testified that offering DSL transport services in an exchange without signing up with any ISPs would, from the end-users perspective, not be an offer at all.

(ICC Staff Ex. 1.0 at 28).

Dr. Liu's ultimate conclusion is that DSL services are the only type of advanced services that Verizon currently "offers" to its residential/small business customers. As previously explained, DSL services are the only type of services that Verizon actually offers or markets to its residential/small business end-users. DSL services are also the only type of advanced service that Verizon makes available to its residential/small business end-users (in some of its serving areas) at rates that can be attractive to and that are intended to attract and be affordable to these end-users.

Verizon asserts that these two paragraphs are inconsistent. In the first paragraph, Staff acknowledges that whether Verizon meets Staff's new definition of "offer" depends on whether an ISP is willing to provide DSL internet access in that

exchange. Clearly, Staff is conceding that whether Verizon meets its new definition of offer is out of Verizon's hands because it is not an ISP. However, in the next paragraph, with no explanation whatsoever, Staff provides Dr. Liu's "ultimate conclusion" which is that DSL TS is the only type of advanced services that Verizon currently "offers" to its residential/small business customers. There is no basis or explanation for this "ultimate conclusion." In reality, Staff's definition of these terms is ill conceived and not legally proper. As such, they should be rejected.

Verizon then asserts that, while Staff makes various allegations in its brief regarding Verizon's presentation of customer data, these allegations do not contain any legal argument, but instead are a point-by-point regurgitation of Staff witness Liu's direct testimony. Verizon argues that each of the points made by Dr. Liu was fully rebutted in Verizon witness Trimble's Rebuttal and Surrebuttal testimonies.

Staff's allegations relate to the issue of customer data. Staff first complains that Verizon did not provide a definition of "customer." Second, Staff complains that Verizon was unable to provide customer segmentation information by central office or by form of advanced services offering. Staff's position is unreasonable in both instances and, according to Verizon, the customer data issue in particular illustrates Staff's unreasonable approach to Verizon's waiver application and exhibits a fundamental misunderstanding of the information limitations of an ILEC's data systems. Even though the evidence demonstrates that a precise estimate for the number of customers (whether by location or not) is likely to be an impossible task (especially for business customers), Staff's position will not bend from a standard that is virtually impossible to meet.

In terms of Staff's arguments relating to Verizon's offering of high speed services to residential and small business customers, Verizon asserts that the record demonstrates that all residential and small business customers can purchase FR, HCD, and ATM services from Verizon. These are tariffed services that are "offered" to all customers willing to abide by the terms and conditions of the appropriate tariff on file with the Commission. There are no class-of-customer "user restrictions" embedded in any of the tariffs for these services. In short, such services are offered to all customers, consistent with the terms and conditions of Verizon's tariffs.

Verizon then addresses Staff's allegation that Verizon does not offer port and access FR and ATM services to 100% of its big business customers, even though it may offer port only FR and ATM services to 100% of its big business customers and that port only FR and ATM services cannot be classified as an advanced services under Section 13-517 because they do not, on their own, deliver information to or from the end-user at any speed. Verizon indicates that Staff's belief is apparently based on the fact that many of Verizon's exchanges were only designed as having "port only" FR or ATM services available.

Verizon asserts that Staff's argument is incorrect. In terms of Section 13-517 compliance, it does not matter what level of coverage each advanced services product

has throughout Verizon's market areas because the issue is the combined coverage of all the advanced services product offerings. If one product has 100% market coverage, the coverage of the other products is not relevant. In this regard, there is no disagreement that DS-1 services (a HCD offering) are available throughout every Verizon exchange. This service alone should make the evaluation of coverage by other services an academic exercise.

Nonetheless, the record demonstrates that Staff's contention is based on a fundamental misunderstanding of Verizon's tariffs. Verizon witness Trimble clearly testified that both FR and ATM can be purchased under two options: (a) port and access, or (b) port only (when the customers area is beyond a typical port and access service area). Mr. Trimble testified that complete FR or ATM service can be obtained in any exchange in which the service is offered. The "port and access" offering can only be purchased if the customer is located in an exchange that either has a FR/ATM switch located within that exchange or has a FR/ATM switch located in a nearby exchange and has Verizon wholly owned facilities back to the FR/ATM switch. The FR/ATM switch exchange along with the surrounding exchanges where Verizon offers the bundled "port and access" service is referred to as Verizon's FR/ATM "cloud." If the customer is outside of the given "cloud," the appropriate access line would typically require a meet-point facility with another carrier. In such a case, the customer must purchase through Verizon's special access tariff to facilitate delivery of the service. Nonetheless, Verizon's claim that its FR and ATM services are available to 100% of its customers is true. Verizon concludes that Staff's position on this issue is based on a misunderstanding of Verizon's tariffs and should be rejected.

Verizon then turns to arguments relating to its waiver request. Verizon begins by again asserting that it does not have an intrastate offering, aside from those subject to the certification request, which qualifies as an advanced service under the Act. It reiterates that its DSL TS is an interstate service subject to the jurisdiction of the FCC. According to Verizon, the Commission cannot require the deployment of this interstate service in order to satisfy the legislative mandate. Again, the General Assembly did not define DSL TS as the measure to accomplish the mandate (Section 13-517 being technology neutral) and the Commission has no jurisdiction over such a product. See 220 ILCS 5/13-517. To order otherwise would be unlawful, and certainly impractical, if not technically infeasible.

While Verizon does not waive the issue of jurisdiction, it argues that the record here demonstrates that DSL TS cannot be deployed without undue economic burden in the Waiver Areas. The record demonstrates that the Waiver Areas are largely rural and the high cost of deploying DSL TS there is not economically justified in light of the actual penetration rates that Verizon has experienced in areas where it is already deployed. A forced deployment in the Waiver Areas will result in significant revenue shortfalls and substantial subsidies. Verizon has established that a ubiquitous deployment of DSL TS to 80% of Verizon's relatively rural customer base would be impractical and unduly economically burdensome, not only to Verizon (Section 13-517(b)) but to Verizon's customer base (Section 13-517(a)).

According to Verizon, the Initial Briefs of Staff and the AG illustrate the faulty nature of their positions. As noted above, it is telling that neither Staff nor the AG once mentions the actual penetration rate that Verizon has experienced in areas in Illinois where DSL TS is already deployed, even though the record demonstrates that Staff has had this information since October of 2002. This is because their respective analyses would collapse if the actual penetration rate were used. Accordingly, both the analyses of Staff and the AG lack credibility and should be rejected.

In terms of the jurisdictional issue, Verizon asserts that the FCC has clearly stated that DSL TS is not an intrastate service. The FCC ruled directly on this issue in *In the Matter of GTE Telephone Operating Cos.*; GTOC Tariff No. 1; GTOC Transmittal No. 1148, 13 FCC Rcd 22466 (1998), *reh'g denied*, 1999 W.L. 98039 (1999) (“*GTE-DSL*”), wherein the FCC found that DSL-based internet connections do not terminate at the ISPs local server, but continue to the Internet. In that case, GTE filed a tariff with the FCC to provide high-speed access connection between an end user subscriber and an ISP. GTE’s service would use the customer’s local loop, a specialized DSL-equipped wire center and transport to the network interface where the ISP was connected to the GTE network. In a ruling addressing a number issues, the court concluded that the GTE-DSL service is interstate.

Verizon notes that Staff does not address the issue of jurisdiction directly, but instead states that it is the legislature, not the Commission that is requiring the deployment of DSL TS. In so doing, Staff seems to take the position that the issue of jurisdiction is somehow irrelevant to what action the Commission should take in the proceeding because the Commission would simply be implementing an Illinois legislative requirement should the Commission require the deployment of DSL TS in this proceeding. Staff states as follows:

Verizon contends that the requirements of Section 13-517 do not require DSL. Verizon Ex. 2.0 at 7. Verizon submits that “interstate services, of which DSL is one, are not within the jurisdiction of the state.” Verizon Ex. 2.0 at 7. According to Verizon, the Commission does not have “the authority to require deployment of DSL” because it is an interstate service. Verizon Ex. 2.0 at 9. Verizon’s arguments are in error for several reasons. ***First, the Commission is not requiring Verizon to do anything – the Legislature has already done that.*** With respect to the State Legislature, Staff does not share Verizon’s view that a jurisdictional issues is presented.  
(Staff Init. Br., p. 41, (emphasis added)).

Verizon finds Staff’s argument a nonstarter. Section 13-517 does not mention DSL TS, let alone any particular advanced services. In other words, Section 13-517 is silent with respect to which service must be offered or provided to satisfy the deployment of “advanced telecommunications services” except that whatever service is offered or provided must be “capable of supporting, in at least one direction, a speed in

excess of 200 kilo-bits per second (kbps) to the network demarcation point at the subscriber's premises." As a number of services satisfy the only statutorily stated requirement, the statute cannot be read to demand the deployment of any one of those services, such as DSL TS.

To the extent that the General Assembly's silence on this issue could be found to create ambiguity, such ambiguity must be resolved in a manner that is consistent with state and federal jurisdiction. It is a well established principle of statutory construction that statutes must be construed in connection and harmony with existing law, and in a manner that imparts constitutionality to statutory provisions. *Dornfeld v. Julian*, 104 Ill.2d 261 (1984); *Arnolt v. Highland Park*, 52 Ill.2d 27 (1972). If more than one construction is possible, a statute will not be construed in derogation of the law. *In re W.W.*, 97 Ill.2d 53 (1983); *Balmes v. Hiab-Foco*, 105 Ill.App.3d 572 (1<sup>st</sup> Dist. 1982). In this case, states do not have jurisdiction over or the authority to mandate the deployment of DSL TS because DSL TS is an interstate service subject to the FCC's exclusive jurisdiction. To the extent that Section 13-517 could be interpreted to mandate the deployment of DSL TS in Illinois, the statute would exceed state jurisdiction. Section 13-517 of the Act should not be construed to require the Commission to act in excess of its jurisdictional authority by requiring the deployment of DSL TS in Illinois. To the extent any such construction would be made, the statute would be unconstitutional and legally void.

Staff cites a recent case for the proposition that when presented with a similar issue in connection with Section 13-801 of the Act, the Commission rejected outright attacks on the propriety of the legislative mandates contained in Public Act 92-0022. (*Illinois Bell Telephone Company: Filing to Implement Tariff Provisions Related to Section 13-801 of the Act*, ICC Docket No. 01-0614, Order at 31-34 (July 11, 2002) ("SBC Order")). The problem with Staff's argument is that, in reality, the SBC Order strongly supports Verizon's position.

The SBC Order cited by Staff addressed Section 13-801 of the Act. 220 ILCS 5/13-801. This Section of the Act specifically acknowledges that the FCC has jurisdiction over interconnection, collocation, network elements, and access to operations support systems. However, despite the FCC's primary jurisdiction over such matters, Section 261(c) of TA96 also expressly permits states to impose regulations on telecommunications carriers for "*intrastate services*" provided such regulations "are necessary to further *competition*" and "are not inconsistent with §§251 to 261 of TA96 or the FCC's regulations to implement such Sections. 47 U.S.C. §261(c)(emphasis added). Accordingly, in Section 13-801 of the Act, the General Assembly carefully identified what it saw as the Commission's jurisdiction:

Sec. 13-801. Incumbent local exchange carrier obligations.

(a) This Section provides additional State requirements contemplated by, but not inconsistent with, Section 261(c) of the federal Telecommunications Act of 1996, and not preempted by orders of the Federal Communications Commission. A telecommunications carrier not

subject to regulation under an alternative regulation plan pursuant to Section 13-506.1 of this Act shall not be subject to the provisions of this Section, to the extent that this Section imposes requirements or obligations upon the telecommunications carrier that exceed or are more stringent than those obligations imposed by Section 251 of the federal Telecommunications Act of 1996 and regulations promulgated thereunder. 220 ILCS 5/13-801 (emphasis added).

Verizon asserts initially that the SBC Order is distinguishable because Section 261(c) grants the General Assembly and the Commission the authority to regulate intrastate services for the purpose of promoting competition, provided the General Assembly and the Commission do so consistently with TA96 and the FCC's implementing regulations. In the SBC Order, the Commission found that Section 13-801 fell within these parameters. An interpretation that Section 13-517 requires the deployment of DSL TS, however, would not fall within the parameters of state regulation authorized by Section 261(c) for two reasons—(i) DSL TS is an interstate service, and (ii) the purpose of Section 13-517 is not to promote competition. Congress did not include a similar statutory grant for states to exercise jurisdiction over DSL TS or for purposes other than the promotion of competition in the Communications Act. Accordingly, the SBC Order is distinguishable from and irrelevant to the Commission's decision in this proceeding.

Staff also argues that “there is no basis to assume that federal law preempts state and local regulations such as Section 13-517 of the Act.” (Staff Init. Br., p. 4). Surprisingly, Staff cites Section 253 of TA96 which prevents a state from prohibiting a carrier from providing any interstate or intrastate telecommunications service. In particular, Section 253 provides:

No State or local statute or regulation, or other State or local legal requirement, may **prohibit** or have the effect of **prohibiting** the ability of any entity to provide any interstate or intrastate telecommunications service.

47 U.S.C. § 253(a)(emphasis added).

Verizon finds Staff's citation to Section 253 confusing because Staff does not purport to “prevent” the deployment of DSL TS through Section 13-517, but rather argues that Section 13-517 *requires* the deployment of DSL TS. Even if Section 13-517 does not require the deployment of DSL TS, there is certainly no basis to interpret Section 13-517 as somehow prohibiting the deployment of DSL TS. The concern raised by Section 253(a) of TA96 is simply not raised in this instance. Staff does not explain how Section 253(a) is relevant to the issue of the Commission's jurisdiction (or lack of jurisdiction) over DSL TS. Clearly, this Section has no bearing whatsoever on the instant controversy.

Verizon continues that Staff also erroneously cites Section 253(b), which states as follows:

Nothing in this section shall affect the ability of a State to impose on a competitively neutral basis and consistent with section 254, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers.  
47 U.S.C. § 253(b)

Verizon asserts that Staff stated that this section somehow bestows states with the right to enact laws and regulations for purposes of, *inter alia*, safeguarding and protecting the interest of the state and its citizens. According to Verizon, however, Section 253, in its entirety, addresses the removal of barriers to entry to the provisioning of telecommunications service. Subsection 253(a), set forth *supra*, prevents states from enacting statutes or implementing regulations that prevent carriers from entering telecommunications markets. Subsection 253(b) simply provides that nothing “in this section”—meaning Section 253—shall affect states’ ability to impose “requirements necessary to . . . protect the public safety and welfare.” The use of the term “affect” means that Section 253 should not be construed to either increase or decrease states’ ability to impose such regulations. In other words, Section 253(b) intends to preserve the authority states otherwise have to implement such regulations. States did not have the authority to “protect the public safety and welfare” by requiring the deployment of an interstate service—DSL TS—prior to the enactment of Section 253. Section 253(b) cannot be read to create in the states authority over an interstate service that the states did not otherwise have. In other words, Section 253 does not affect the jurisdictional analysis, which relies mainly on Section 1, 2 and 3 of the federal Communications Act, set forth *supra*. According to Verizon, Staff’s interpretation plainly is incorrect and inconsistent with the language of Section 253(b).

Finally, Staff cites a United States Supreme Court decision for the proposition that “[i]n the interest of avoiding unintended encroachment on the authority of the States, . . . a court interpreting a federal statute pertaining to a subject traditionally governed by state law will be reluctant to find preemption.” (Staff Init. Br., p. 43 *citing* *CSX Transp. v. Easterwood*, 507 U.S. 658, 664, 113 S.Ct. 1732, 123 L.Ed.2d 387, (1993) Verizon asserts that this is another case that actually supports its position because CSX only applies to subjects “traditionally governed by state law.” Regulation of DSL TS is a federally regulated service that was never the subject of Commission regulation. As such, DSL TS is not “a subject traditionally governed by state law” and CSX is inapplicable for the proposition Staff claims.

Verizon concluded that the Commission is preempted from regulating and mandating DSL TS and, accordingly, Section 13-517 cannot be interpreted in a fashion that requires the Commission to mandate the deployment of DSL TS.

Verizon next responds to arguments relating to it meeting its burden of proving that deployment of DSL TS in the Waiver Areas is not financially viable. Verizon begins by noting that Staff witness Liu agreed that an incremental analysis of the issue is

appropriate and that the provision of DSL TS in the Waiver Areas would be unduly economically burdensome for the Company. Nonetheless, Staff and the AG each allege that Verizon has not met its burden of proof. Verizon argues that both Staff and the AG misapprehend the concept of burden of proof; that the AG does not cite to any authority on this issue; and that, in the two places in Staff's Initial Brief where it discusses burden of proof, it cites to the testimony of lay witnesses as authority, not the law.

Verizon asserts that the Staff and AG position is apparently that once a request is made for any type of data, whether relevant, available, or otherwise, and this data is not provided, a party will not make its case. It is also apparently their position that they do not have to provide any explanation as to why such data is even relevant. These parties are mistaken and do not realize that they too have a burden of going forward. In this respect the law is clear.

Verizon asserts that once a utility establishes a *prima facie* case, the burden then shifts to others to show that the company's case is unreasonable. *People of Cook County, et al v. Illinois Commerce Comm'n*, 237 Ill. App. 3d 1022, 1029; 606 N.E.2d 79, 83-84 (1<sup>st</sup> Dist. 1992); *City of Chicago v. Commerce Comm'n*, 133 Ill. App. 3d 435, 443; 2478 N.E.2d 1369, 1375 (1st Dist. 1985). Contrary to these decisions, Staff and the AG attempt to make their cases through general objections, not evidence. They repeatedly state conclusively that they need data regarding Verizon's full deployment, interstate operations and number of customers, but they never provide support explaining why such data is necessary or relevant. They simply summarily state that such data is necessary.

In response to Staff's position that Verizon did not provide the information necessary for it to formulate a position with respect to Verizon's alternative waiver request, Verizon surmises that Staff's allegation relates to pro-forma financial information, incremental versus full deployment data, and number of customers' data. Verizon asserts that Staff's requests are not relevant and responses are not required because less burdensome alternatives to the data exist.

In terms of the AG's position, Verizon notes that the AG did not proffer direct testimony in this proceeding. Moreover, the AG failed to serve a single independent data request to Verizon. For the AG to now state that Verizon did not provide sufficient information is, according to Verizon, unreasonable and disingenuous.

In response to Staff's claim that it needs interstate pro-forma financial data, Verizon asserts that this claim is unsupported because the record demonstrates that Staff was able to calculate the financial impact upon Verizon with the intrastate data presented to Staff. Further, Staff concedes that it is improper for the profitability of Verizon's operations in other states to affect the decision for offering advanced services in Illinois. As such, Staff has not provided any justification for its request for interstate data.

Verizon asserts that there are other problems with Staff's alleged need for this information. First, Staff's insistence that they cannot complete their evaluation of the significant adverse effect on the Company's financial integrity, is based on the faulty assumption that Section 13-517 requires such an analysis. Section 13-517 contains no language stating that "a significant adverse effect on its [ILEC's] financial integrity" is a necessary criterion for granting an ILEC's request for a waiver (let alone even a stated criteria).

Moreover according to Verizon, Staff's position that the financial integrity of the ILEC must be impaired before a waiver is granted illustrates Staff's misguided and illegal view of Section 13-517. The problem is that Staff views the terms "undue economic burden" and "adverse economic impact" in isolation. Staff improperly turns a blind-eye to whether the investment itself is prudent. Indeed, on cross examination, Staff witness Liu could not agree that it would be unduly economically burdensome for the company to hypothetically make a \$100 million DSL TS investment and have only one customer take this service. This position is unreasonable and inconsistent with the General Assembly's clear mandate regarding the ". . . development of and *prudent investment in* advanced telecommunications services . . . ." 220 ILCS 5/13-517 (emphasis added). Taken to its logical extreme, Staff's definition of these terms would lead to a requirement to make the investment even if the projected penetration rate is zero. This interpretation clearly is in conflict with the Act. A deployment of DSL TS at a loss does not meet the Act's requirement that investment in advanced services be prudent and competitively neutral.

Verizon, nonetheless, provided Ms. Freetly with a set of intrastate pro-forma financials, reflecting the impact of the requirements of Section 13-517. This information was submitted as a revised response to Staff's Data Request FIN-4. However, Staff complains that Verizon's response only related to its Illinois intrastate operations. Staff's complaint reveals Staff's intent to review Verizon's interstate operations, something that has no relevance in this proceeding, and additionally, is outside the Commission's jurisdiction.

Verizon goes on to assert that this is another area where Staff's testimony is utterly inconsistent. On the one hand, Staff requests company-wide interstate/intrastate pro-forma information. On the other hand, Staff also admits that profitability of Verizon's operations in other states should not affect the decision for offering advanced services in Illinois. In describing its calculation of the economic effect that offering advanced services has on Verizon's ability to provide a fair rate of return to its common equity shareholders, Staff acknowledged the following:

Staff estimated the effect of offering advanced services on Verizon's jurisdictional return on common equity by calculating the implied rate of return on equity ("ROE"). As Staff explained, implied ROE represents an estimate of Verizon's earned rate of return on the equity portion of net utility rate base for its Illinois intrastate operations. Staff used implied ROE because Verizon North and South operate in several jurisdictions,

and any analysis based on company-wide data would wrongly imply that the profitability of Verizon's operations in other states should affect the decision for offering advanced services in Illinois.

Verizon notes that an implied ROE analysis reflects the financial impact on Verizon's operations in Illinois only. In addition, implied ROE illustrates the effect on Verizon's ability to provide a fair return to its shareholders on its Illinois investment if required to offer advanced services to its customers in Illinois in accordance with Section 13-517(a). According to Verizon these two positions are diametrically opposed and cannot be reconciled. Further, according to Verizon, this statement in Staff's Brief is an admission that the pro-forma data that Staff seeks is not relevant.

Verizon goes on to notes that, although Verizon did not provide the pro forma financial statements that Staff requested, Staff was able to use the information that was provided by Verizon to estimate the economic effect that offering Advanced Telecommunications Services ("advanced services") has on Verizon's ability to provide a fair rate of return to its common equity shareholders. Staff estimated the effect of offering advanced services on Verizon's jurisdictional return on common equity by calculating the implied rate of return on equity ("ROE"). Here Staff is acknowledging that other less burdensome alternatives exist to interstate/intrastate company-wide pro-forma data. According to Verizon, Staff did perform such an analysis and found that the provision of DSL TS in the Waiver Areas would be unduly economically burdensome for the Company.

In addition, Verizon indicates that Staff's position that the financial integrity of the company must be impaired before a waiver can be granted inherently assumes either: a) intraservice or interservice subsidies between other services or existing DSL TS deployments and deployments in the Waiver Areas and/or b) shareholder responsibility for the revenue shortfalls. The record demonstrates that neither of these scenarios is valid.

In response to Staff and the AG claims that they need data relating to Verizon's full deployment of DSL TS throughout the state in order to formulate a position, Verizon responds that neither party provided any credible justification for this data. Indeed, according to Verizon their positions are inappropriate for several reasons. First, Staff acknowledged the reasonableness of Verizon's waiver request when Dr. Liu stated that an undue economic burden occurs where the incremental costs of deployment are greater than the incremental revenues. Dr. Liu further testified that the correct approach is an incremental approach, where the Commission must weigh the incremental costs and benefits associated with the investment, and the amount of investment should be compared with the overall benefits that the investment will produce. According to Verizon, in the instant case, the high investment cost coupled with inadequate revenues must be factored into the decision as to whether the economic burden is an undue one. In light of the fact that the General Assembly made it an express policy that investment must be prudent, this cost/benefit analysis is legally required.

The second reason that data relating to the full deployment of DSL TS was not required was that the data is not relevant to this Docket. Verizon is not seeking a waiver for the areas where DSL TS is currently deployed or already slated for deployment. Neither Staff nor the AG provide any basis whatsoever in their respective briefs as to why this full deployment data is necessary. They each only provide a conclusion without any support. Accordingly this position is baseless and should be ignored.

Third, the only possible relevance for this additional data is for current deployment to subsidize deployment in the Waiver Areas, where DSL TS deployment would not be profitable on a stand-alone basis. Staff witness Zolnierrek acknowledged this fact during cross-examination. The AG implies this in its brief without using the word “subsidy” once, from which Verizon infers the AG's acceptance of the principle that subsidies are totally improper and inefficient. Moreover, this additional data is not relevant because the Commission does not have the legal authority to mandate subsidies of a service that is exclusively subject to federal jurisdiction.

Fourth, Staff's own witnesses stated on cross-examination that Staff had not previously asked for this data. Nowhere in Staff's testimony is a need for this data stated. Clearly, Staff did not consider this data relevant at the time that its direct or rebuttal testimony was filed. With respect to the AG, not only did it not proffer one independent data request, it never mentioned the issue of incremental data versus full deployment data in its testimony. From this, Verizon argues that presenting the argument for the first time in Briefs is disingenuous.

Finally, Verizon asserts that as early as October, 2002, Verizon provided information to Staff indicating that its actual penetration rates for DSL TS differ dramatically from the illustrative 17% rate utilized in its waiver request. As such, even without Verizon's data on full deployment, it goes without saying that profits are not “supra-normal.” Clearly, Staff's request for such new data is inappropriate and should be rejected.

In sum, Verizon asserts that it properly provided data relating to the Waiver Areas. It is not until the 11<sup>th</sup> hour (supplemental rebuttal testimony for Staff and Initial Brief for the AG), that Staff and the AG even raise this issue. As argued previously, Verizon finds the requests to be for information that is not relevant and the arguments not credible.

Verizon next addresses Staff's challenge to how the “80 percent of customers” threshold is calculated. Verizon first recounts that, with respect to customer information, Verizon has presented data that accurately sets forth compliance with Section 13-517 based on two alternative scenarios:

- (1) potential customers were defined as a subset of switched access lines (potential DSL TS lines) and the “percent of total customers” in an

area is equal to the “percent of the Company’s total potential DSL lines” in that area (Verizon Ex. 2.0, Trimble Dir., p. 20); and

(2) number of customers is equal to number of customer bills which can then be evaluated based on relationships between bills and switched access line data; (Verizon Ex. 4.0, Trimble Reb., pp. 16-19).

Verizon argues that the record demonstrates that Verizon’s approach is reasonable and accurate. Indeed the latter evaluation presented extremely strong statistical data that Verizon’s financial presentation is consistent with the 80% threshold required by Section 13-517. While Verizon provided these two alternative scenarios to corroborate the fact that its coverage statistics are accurate, Staff mistakenly characterizes Verizon’s approach as inconsistent.

Verizon urges that, at the core of Staff’s argument is its misguided definition of “customer.” Staff’s Initial Brief, while criticizing Verizon’s methodology, never provides a definition of “customer.” Rather, Staff utilizes Dr. Liu’s assumption that “customers” are the equivalent of end-users, under Section 13-517 of the Act. Dr. Liu also considers end-users at multiple locations to be considered a customer at each location. Dr. Liu also contends that Competitive Local Exchange Carrier (“CLEC”) users served through ILEC network facilities should also be considered customers of the ILEC, and customers should be segmented into two categories: (1) residential/small business, and (2) big business (at least 4 access lines) due to differences in demand characteristics and demand patterns.

Verizon takes issue with Staff witness Liu’s definition of “customers.” The record demonstrates that her attempt to segment customers into two categories and locations is both immaterial and impractical. Verizon argues that, even if “end-user” could be a rational definition for a customer, Staff is oblivious to the information limitations in ILEC’s data systems. Verizon witness Trimble testified that a precise estimate for the number of customers (whether by location or not) is likely to be an impossible task (especially for business customers). Verizon argues that creating a definition that imposes significant costs on ILECs should be viewed with a jaundice eye; the objective should be simplicity, subject to acceptable levels of variability in the expected estimations.

Staff nonetheless insists on obtaining customer segmentation data, regardless of cost and whether the data is even practical. Verizon notes that Section 13-517 does not require customer segmentation. Further, the record demonstrates that it is cost prohibitive and impractical to obtain such data. This is because most ILECs have two general types of data systems: (1) engineering-related ones, and (2) billing-related ones. A customer’s (or end-users) consumption of services is captured in both types of systems. However, engineering systems would not have the desired capability to identify customer information (especially if business / residence segment information is required). On the other hand, the billing system has a basic unique identifier (e.g., the “billing number”) as well as some semblance of customer-specific demands.

Verizon asserts that its billing system cannot determine an absolutely precise estimate of customers because many business and residential customers receive multiple bills. Business customers' bills can be sorted based on number of switched lines that were billed to create an estimate of customers by line size. However, the estimate undoubtedly will be larger than the actual number of businesses. Similarly, a count of residential bills could be used as an estimate of residential customers even though the count of residential primary lines would likely provide a better estimate.

Verizon phrases the issue before the Commission as whether these total customer statistics from billing records can be used to compute advanced services coverage and the answer is they cannot. Substantial additional data processing would be required to determine, based on billing number, whether the customer can purchase an advanced service (assuming billing numbers could be used for this task). The record demonstrates that an exercise of this nature should not be undertaken because the significant costs outweigh the limited benefits that this data would provide. This is especially true to allow recovery of the additional costs companies will incur to continually show that they are in compliance with Section 13-517. As such, the procedure employed by Verizon—computing the percent of customers based on the percentage of switched access lines—presents a much more rational approach to this issue.

Moreover, Verizon asserts that it has adequately demonstrated that its 80+% target for access line coverage covers 80% of the customers. In Mr. Trimble's rebuttal testimony, he presents an analysis based on billing-number information that confirms this fact. Mr. Trimble provided two separate extreme scenarios in terms of how a company could achieve 80% customer coverage. Mr. Trimble testified that the real figure will be somewhere in between each of these scenarios. Verizon has already deployed to most of the areas served by its largest central offices. In addition, Verizon's proposed deployment to satisfy the waiver requirements would include deployment in every central office such that coverage of business customers should approach 95+% (since they are usually located in urban areas). The 80+% target for access lines that Verizon used in its waiver application is consistent with achieving coverage for 80% of all of Verizon's customers. Mr. Trimble further noted that even if the number of business customers were lowered (due to customer versus billing numbers) there would not be any major impact on the resulting percentages. This "access line related" process allows Verizon to show what level of lines would need to be DSL-qualified to satisfy Section 13-517 while, at the same time, drastically simplifying the chasing of numbers and customer segments.

Verizon goes on to assert that the customer segmentation data sought by Staff is immaterial to determining compliance with Section 13-517. This is because a simple percent-of-access-line measure can be developed that can assure compliance is achieved. Furthermore, even using Dr. Liu's definition of "offer," the segmentations provide no additional value to determining compliance with Section 13-517. Under Dr. Liu's definition of "offer," the only vehicle ILECs currently have to address the residential/small business customers is DSL TS. Once DSL TS capabilities are

deployed in a switch, all customers have the potential to become qualified. The businesses served out of that switch are most likely to be qualified since they are usually closer to the switches. Thus, deploying DSL TS capabilities just gives big businesses another option. Knowing that big businesses have other options when DSL TS capabilities are not deployed does not change where the ILEC (especially Verizon) will need to deploy DSL TS capabilities to achieve compliance with Section 13-517. Verizon still will have to deploy in all the switches where the big businesses are located.

Verizon next turns to the interpolations of costs and revenues performed by the Staff and the AG using the 17% penetration rate contained in Verizon's initial case. Verizon asserts that the use of this penetration rate is incorrect and that, if Staff and the AG had used the penetration rate reflective of Verizon's actual experience for DSL TS, their arguments collapse.

Verizon begins by noting that, throughout direct, rebuttal and surrebuttal testimonies, Verizon witness Trimble repeatedly stated that the demand penetration estimates that he employed in the financial analysis were extremely aggressive and utilized only to avoid any contentious debate regarding the appropriate level of demand penetration. This approach was taken because even under these unrealistic estimates, Verizon was of the opinion that the results of the analysis indicated that advanced services are not economical in the Waiver exchanges.

Verizon goes on to argue that the problem is compounded by the fact that neither Staff nor the AG consider or employ Verizon's actual Illinois penetration rate in their analyses or in their respective briefs. Verizon finds this incredible in light of the fact that this figure is clearly a better indicator of expected penetration rates than the 17% figure used by Staff and the AG. It is for this reason that their analyses lack credibility and should be given no weight whatsoever. Verizon further notes that neither Staff nor the AG can state that they were not aware of the actual figure because, as Verizon witness Trimble testified, Staff has been aware of this figure since October of 2002. Further, neither Staff nor the AG disputes the accuracy of this figure.

Verizon asserts that the starting point for their calculations should have been the actual take rate, not 17%. Because every calculation presented by the AG and Staff are based on a penetration rate that is markedly greater than what Verizon is actually experiencing, Verizon argues that the results lack credibility whatsoever and should be rejected.

Verizon next addresses Staff's assertion that it performed an analysis to determine whether Verizon's data indicates that the Company could comply with Section 13-517(a) for some group of exchanges without causing one or more of the statutory waiver conditions to occur. According to Staff, its exchange level analysis of Verizon's incremental cost and revenue data indicates that Verizon could comply with Section 13-517(a) for 270 exchanges (the "non-waiver group") included in Verizon's waiver request without causing a significant adverse economic impact on users of telecommunications service generally or an undue economic burden on the Company.

Verizon asserts that Staff's analysis is severely flawed because it also relies upon the overstated 17% penetration rate in its calculations. Verizon argues that, for same reasons stated above, Staff's analysis is not accurate and misrepresents the 17% penetration rate as Verizon's assumed penetration rate. This is not true because this 17% figure was only provided to illustrate that even under the most optimistic of assumptions, deployment of DSL TS is not a financially viable proposition. Indeed, Staff's refusal to even acknowledge actual take rates is clearly an indication that its analyses crumble if it plugs in this more realistic figure. Even if, *arguendo*, the Commission were to accept the 17% penetration, Staff failed to recognize that this figure would represent an average, and that, by definition, some of the exchanges would experience penetration less than 17%, creating an overstatement of its final results.

In response to the AG's position that DSL TS deployment to 69.9% of Verizon customers to whom DSL can be made available through central office deployment is financially viable, Verizon responds that the AG's analysis is fatally flawed because, similar to Staff, the AG improperly rely on a 17% penetration rate. For reasons stated above, the AG is misusing the data to support its recommendation. Verizon notes that while the record overwhelmingly demonstrates that Verizon's expected penetration rates would be the take-rate experienced where DSL TS has been deployed in Illinois, the AG does not even mention Verizon's actual penetration rates once in its brief. Similar to Staff's analyses, the AG's calculations also fall apart when a realistic take rate is incorporated.

Verizon goes on to note that neither Staff nor the AG recognize other competing technologies, whether existing or emerging, that will place even more downward pressure on Verizon's expected penetration rates. The silence of these parties on this critical issue reinforces the lack of credibility to their respective one-sided analyses. Verizon points to Staff witness Liu's testimony on cross-examination, which, it asserts, speaks volumes on this issue. When asked about the possibility that DSL TS may be obsolete within five years, Dr. Liu responded that it was "entirely possible" that this could happen. (Tr. at 341). This statement, again, illustrates that Staff and the AG do not address the consequences associated with their respective proposals.

Verizon next addresses Staff's position that a temporary waiver should be granted to only 173 of Verizon's exchanges where revenues were less than 58% of costs (*i.e.*, the most unprofitable exchanges). Verizon terms the position unreasonable and asserts that Staff is basing its conclusion on its exchange level analysis, which expressly calculates expected revenues based on an unrealistic 17% penetration rate. As stated above, this penetration rate was not presented to support making such a significant investment. As such, Staff's position, along with all of its calculations, are faulty and should be rejected. Furthermore, Staff's position requires existing deployments to subsidize new deployments. Staff states as follows:

Verizon could, according to its own data, deploy DSL services to some of the exchanges with less than a 100% revenue ratio and still break even. Staff Late Filed Exhibit 2. This analysis shows that DSL could be deployed to the group of exchanges with a revenue ratio of 45% and above and still break even. Staff Late Filed Exhibit 2. (Staff Init. Br., p. 79).

By aggregating exchanges that will allow Verizon to “break even,” Staff is advocating that marginal exchanges will be supported by existing deployments. Verizon asserts that such intra-service subsidies are inefficient and will cause a host of competitive issues. Moreover, Staff’s assumption that current deployments can subsidize new deployments is wrong. Considering the penetration levels that current deployments are experiencing, Verizon finds it unlikely that these areas can be relied on for subsidies, even if the Commission accepted Staff’s position.

Finally, Verizon addresses Staff’s proposed one year extension for Waiver Area exchanges. Verizon states that it is strongly opposed to any timed extension. However, should the Commission believe otherwise, any such extension should be to a time when the Commission can better access the state of technology and competition. Consistent with Staff’s own testimony, such an extension would need to be for a minimum of three years, or January 1, 2008. Accordingly, Verizon recommends that if the Commission wishes to limit the duration of a waiver, that duration should be no less than three years from the Act’s January 1, 2005 date and applicable to the entire Waiver Area.

## **F. Staff Replies**

### **1. Certification Replies**

Staff begins by noting that Verizon contends that “no further action is required [by it] to satisfy Section 13-517” because it “offers existing advanced telecommunications services that” meet the transmission speed requirement of 200 kilobits per second (“kbps”) set forth in Section 13-517. Verizon IB at 1. Staff responds that Verizon’s arguments lack merit and only serve to demonstrate that the Company disagrees with the action of the legislature in passing Section 13-517. Verizon’s disagreement with the goals and intent of Section 13-517 do not provide an adequate basis to grant its waiver request. Indeed, as will be explained below, Verizon’s arguments only serve to emphasize the deficiencies in its positions.

While Verizon explains why it would like to receive a certification from the Commission concerning its compliance with Section 13-517, Staff finds that the reasons given do not overcome the legal impropriety of its request and are little more than the normal reasons parties express in connection with a desire for an advisory opinion. The personal benefit from receiving an advisory opinion cannot overrule the applicable legal requirements. Moreover, the benefits to adjudicative tribunals from only ruling in the context of actual cases or controversies far outweigh those personal benefits.

Accordingly, Verizon's certification request, as such, must be denied on this ground alone.

Staff next turns to Verizon's arguments that the high speed intrastate services it currently offers satisfy the requirements of Section 13-517. Staff notes that Verizon acknowledges that the services it relies on for its certification request are offered through its existing intrastate tariffs, while admitting that any service used to provide internet access would need to be purchased as an interstate service. Thus, according to Staff, it is not disputed that the services Verizon relies on for its alleged compliance with Section 13-517 would not enable Illinois residents to use those services for internet access. Indeed, Verizon submits that Section 13-517 "does not specifically say internet service . . . ." Tr. at 457. Verizon's position, however, necessarily assumes that services which cannot be used for internet access nonetheless satisfy the requirements of Section 13-517. Verizon's position is directly at odds with the clear intent of the legislature in enacting Section 13-517. Although the language of Section 13-517 does not contain the words internet access, it is clear that the intent and purpose of Section 13-517 was to bring high speed internet access to Illinois citizens.

Staff argues that the primary rule of statutory construction is to ascertain and give effect to the intent of the legislature, *Kraft, Inc. v. Edgar*, 138 Ill. 2d 178 (1990); *Highland Park Women's Club v. Department of Revenue*, 206 Ill. App. 3d 447 (2nd Dist. 1990) and that to accomplish this task a tribunal must look at the statute as a whole, taking into consideration its nature, its purpose and the evil the statute was intended to remedy. *Rogers v. Department of Employment Security*, 186 Ill. App. 3d 194 (2nd Dist. 1989); *In Re County Collector of McHenry County*, 181 Ill. App. 3d 345 (2nd Dist. 1989). Here, Verizon cannot reasonably deny that both Section 13-517 and its companion digital divide funds were primarily intended to bring high speed internet access to Illinois residents.

Indeed, Verizon's attempt to discredit the penetration rates it presented in this proceeding based on the percentage of customers allegedly not owning computers and, thus, not able to access the internet, clearly demonstrates that even Verizon recognizes that the purpose and intent of requiring ILECs to offer advanced services is to bring high speed internet access to Illinois residents.

Staff next responds to Verizon's assertions regarding Staff's analysis of whether the services Verizon relies on to show its alleged compliance with Section 13-517(a) are truly offered or provided to 80% of its customers. Staff's position is "that (1) determination of whether Verizon offers a service to its customers must take into account Verizon's different customer classes; and (2) Verizon should not be deemed to 'offer' a service to a customer unless there is a reasonable expectation that customers within the customer class being considered would purchase such services (at the offered rates)." Staff IB at 27. Staff viewed use of the term "provide" in Section 13-517(a) to involve a straightforward fact based inquiry such that "a carrier 'provides' a service to a customer if the customer is actually taking the service." Staff IB at 25. The linking of "offer" to a showing of some reasonable expectation that customers within the

customer class would actually purchase such services is both reasonable and consistent with the intent and purpose of Section 13-517.

Staff notes that Verizon alleges that “Staff resorts to manufacturing entirely new definitions for the terms “offered” and “provided,” as such terms are used in the statute[,] . . . .” and alleges that “[t]hese manufactured definitions . . . are inconsistent with the common and accepted definitions of these terms . . . .” Verizon IB at 2. Verizon further contends that Staff’s position would find that the Company’s “current intrastate advanced telecommunications services offerings do not meet the requirements of Section 13-517 based solely on the price of the service.” Staff asserts that Verizon’s argument is based on a mischaracterization of Staff’s position. Although price necessarily impacts whether members of a particular customer class would be reasonably likely to purchase a particular services, Staff has not proposed or advocated a pricing inquiry. Rather, Staff has advocated a high level analysis to determine whether there is a reasonable likelihood that members of the customer class would actually purchase the service (at the tariffed rates). This is fully reasonable given the goal of Section 13-517 to bring high-speed internet access to Illinois customers. If there is no likelihood that the services at issue would be purchased or utilized by customers, then the requirements of Section 13-517(a) would be rendered meaningless, contrary to legislative intent and well established rules of statutory construction.

In response to Verizon’s argument that Staff’s definitions of the terms “offer” and “provide” are not the commonly understood definitions of these terms, Staff notes that, while Verizon cites the American Heritage dictionary meaning of such terms, it chooses not to cite the first, and presumably most common, definition of such terms. In footnote 3 of Verizon’s brief, the first definition of “provide” is “to furnish; supply.” Thus, the first definition of “provide” set forth in the Ameritech Heritage dictionary is actually quite similar to Staff’s definition of provisioning or furnishing a service upon acceptance of a contract for service. In footnote 2 of Verizon’s brief, the first definition of “offer” is “to present for acceptance or rejection.” Again, this definition is similar to Staff Witness Liu’s definition with a couple of notable exceptions.

Staff’s definition of “offer” takes into account the possibility that the “offer” is intended solely for the purpose of avoiding compliance with the intended impact of the statute. Staff requires an offer under Section 13-517 to be legitimately marketed to the specific customer segment to which Verizon is claiming the service is offered. Staff explains that there should be a reasonable expectation that customers would purchase a service (at the offered rates) before that service is deemed to be an offer to those customers. Staff asserts that Verizon misses the point in arguing that Staff’s definitions of these terms would lead to absurd results if applied to the interpretation of other statutory provisions. Staff’s point is that permitting offers which are neither bona fide nor realistic to determine compliance with this statute would render the statute meaningless.

Clearly, the legislature intended its mandate to effect some sort of change. If existing services provided to high-end business users would qualify as advanced services offered to 80% of a carrier’s customers, the enactment of Section 13-517

would have been completely futile. It is Verizon's interpretation of Section 13-517 that leads to absurd results. As Verizon witness Trimble admitted during cross examination, under Verizon's view of the term "offer" an item would be deemed to be offered to all customers – even those that have no possibility of being able to purchase that item. Tr. at 476-477. Clearly, this cannot be what the legislature had in mind when it decided to require advanced telecommunications services be made available to Illinois citizens.

Verizon also contends that Staff's treatment of the term "offer" is wrong "because Verizon does not offer its DSL TS directly to end-use (sic) customers." Verizon contends that because DSL Transportation Service is not directly offered to end users, it is inappropriate to determine whether such services are marketed or priced so as to have a reasonable likelihood of being attractive by particular customer groups. According to Staff, this argument elevates form over substance and, if accepted, would serve to directly undermine the intent and purpose of Section 13-517. As established above, the intent and purpose of Section 13-517 is to bring high speed internet access to Illinois citizens. Verizon's DSL TS is intended and designed to be offered as part of a package of services that culminate in high speed internet access for residential and business customers.

Staff concludes that Verizon's legalistic distinction of the relationship between ILEC, ISP and end user is nothing more than a distinction without a difference. It is nonsensical to suggest that the legislative mandate to offer advanced services to 80% of an ILECs customers refers to anything other than end user customers. It is similarly nonsensical to suggest that the provision of a service intended, designed and utilized by ISPs as part of a packaged service that provides high speed internet access to end users is somehow not offered or provided to end users. Moreover, Verizon's assertion is pointless, as Verizon's waiver request assumes that DSL TS would satisfy the requirements of Section 13-517(a) and Staff does not contend that DSL TS is not offered or provided to Verizon's residential and small business customers.

## **2. Waiver Replies**

Staff first responds to Verizon's contentions that "DSL TS is an interstate service subject to the jurisdiction of the Federal Communications Commission ('FCC') . . . [and that ] the Commission does not have the authority to mandate the deployment of this service . . . , or the authority to order that this service be subsidized because the Commission does not have jurisdiction over its pricing." Staff asserts that Verizon has chosen the wrong forum to attack Section 13-517, its arguments ignore the fact that it is the legislature that has imposed these requirements, and its jurisdictional arguments are not well founded as a matter of law.

Verizon's claim that the Commission is without jurisdiction to order deployment of DSL TS or to regulate its price is incorrect. Although DSL TS is an interstate service and subject to the pricing regulation of the FCC, the Commission may assert its authority over deployment of DSL TS facilities. Section 8-401 of the PUA, which was enacted seventeen years ago, provides that "Every public utility subject to this Act shall provide

service and facilities which are in all respects adequate, efficient, reliable and environmentally safe and which, consistent with these obligations, constitute the least-cost means of meeting the utility's service obligations." 220 ILCS 5/8-401. In enacting Section 13-517, the General Assembly was enforcing its long held authority under 8-401 to regulate the facilities of public utilities by addressing a perceived deficiency in the deployment of DSL service facilities. Furthermore, as stated in Staff's Initial Brief, any claim by Verizon that the legislature did not have authority to regulate DSL TS is actually an attack on the statute itself and must be raised in another forum. Staff asserts that the Commission is a creature of state law and bound to uphold the Public Utilities Act.

Verizon's claim that if the Commission mandates Verizon to provide a subsidized DSL TS, the Commission is unlawfully exercising jurisdiction over the price of DSL TS is at the very least premature and may also be an attack on Section 13-517 itself. Staff goes onto argue that in determining whether a waiver under Section 13-517 will be granted, the Commission is not deciding any issues regarding the subsidization of services or the allocation of costs. Staff has pointed out that the issue as to whether the costs of deployment of advance services are to be borne by Verizon's shareholders or by customers is an open question that is not answered definitively by Section 13-517. Consequently, if ultimately the Commission decides that the costs of deployment are to be borne by customers, any subsidization of those costs by customers other than advanced service customers is also an open question to be decided in another proceeding. Verizon's jurisdictional arguments regarding subsidized costs, to the extent they need to be addressed, can be addressed in a subsequent rate case.

Verizon's claim that the Commission does not have jurisdiction over ISPs and therefore the Commission cannot mandate the deployment of advanced services in accordance with Section 13-517, should not be given credence for a number of reasons. First, although DSL TS may be offered to ISPs, as Verizon claims, nothing precludes Verizon from offering these services directly to its customers. Staff's position in this docket has been to give credit to Verizon, not only for DSL TS it may provide directly to its customers, but also for DSL TS it provides indirectly through the use of ISPs. The fact that Staff's recommendation would entitle Verizon to meet its goal of providing advanced services to 80% of its customers, whether the services were offered directly or indirectly through ISPs, does not mean that the Commission, in adopting Staff's recommendation is exercising jurisdiction over ISPs. In fact, the Commission would in no way be regulating ISPs. The Commission would only be interpreting the means by which Verizon could satisfy its obligations under the statute. For all of these reasons Staff urges that Verizon's jurisdictional arguments be given no weight.

Staff next turns to Verizon's arguments that the record demonstrates that it should be granted a partial waiver from the requirements of the Section 13-517 given the nature of its service territory, customer demand for advanced telecommunications services, and the costs to deploy such services. Staff again asserts that Verizon has failed to demonstrate that it meets the statutory requirements for a waiver and its arguments lack merit.

In terms of Verizon's contention that the provision of DSL TS in the areas where it is seeking a waiver would be unduly economically burdensome to both Verizon and its customer base because the resulting revenues will not cover the costs associated with deployment necessary to meet the Act, Staff asserts that Verizon's contention is really that it is too burdensome to deploy everywhere (where it is not currently deployed) so it should not have to deploy anywhere (beyond where it is currently deployed). Staff asserts that this conclusion flows directly from Verizon's incorrect assumption that the only required analysis is the all or nothing analysis that it has presented. Although Verizon acknowledges through quotation of the statutory language that it is required to demonstrate that its requested waiver is "necessary" to avoid one or more of the statutory waiver conditions, Staff asserts that it never addresses this requirement on a substantive level. Staff explains that Verizon cannot satisfy the waiver requirements absent some showing that the waiver conditions relied on for its waiver request cannot reasonably be avoided through a more limited waiver. Staff asserts that its analysis in this regard is consistent with and supported by the opinion in *Citizens Utility Board v. Illinois Commerce Commission*, 276 Ill. App. 3d 730 (1<sup>st</sup> Dist. 1995). In *Citizens* the court considered the showing required by a carrier to demonstrate that its capital structure was necessary for the provision of services. After explaining that the utility bears the burden of establishing that its rates are just and reasonable, the court held that the Commission could disallow recovery of any cost of capital in excess of that reasonably necessary for the provision of services and that the Commission was justified in ordering a utility to perform studies to determine whether a different capital structure could reduce capital costs, which was tantamount to a finding that the utility did not meet its burden of proving that the reported capital structure reflects capital costs reasonably necessary for the provision of services.

Thus, according to Staff, in the same way that the utility in *Citizens* failed to demonstrate that its proposed capital structure was "reasonably necessary" because it did not address the reasonable likelihood that a different capital structure would permit it to meet its capital needs at lower cost, so too has Verizon failed to demonstrate that its proposed waiver request is "necessary" to avoid one or more of the waiver conditions because it did not address the possibility that a more limited or less expansive waiver request would permit it to avoid the waiver conditions and comply to a greater degree with its obligations under Section 13-517. Moreover, Staff's analysis of Verizon's own data indicates that a more limited waiver partial waiver would permit Verizon to avoid the statutory waiver conditions.

Staff next responds to numerous characterizations of Staff's positions made by Verizon. The first characterization is that Staff, through the testimony of Staff witness Freetly, agreed that the provision of DSL TS in the Waiver Areas would be unduly economically burdensome for the Company. Staff agrees that Ms. Freetly testified that "[u]nder the scenario in the Supplemental Rebuttal Testimony of Staff witness Mark Hanson, the impact of offering advanced telecommunications services ('advanced services') on Verizon's implied ROE would appear to constitute an undue economic

burden.” ICC Staff Ex. 3.2 at 1. Staff goes on the note that Ms. Freetly further qualified her testimony by cautioning that:

However, this scenario represents the incremental revenues and costs associated with deploying advanced services and does not reflect the revenues and costs from the current deployment of advanced services. It is not appropriate to exclude the effects of the current deployment because then the analysis does not reflect the profitability of the service in full. Therefore, the financial impact on the company may be overstated in this analysis, depending on the profitability of advanced services that Verizon already offers and provides.

ICC Staff Ex. 3.2 at 2.

Staff argues that this does not constitute an agreement about anything. Rather, Staff witness Freetly testified only that the impact of the incremental cost and revenues associated with Verizon’s proposed ubiquitous DSL deployment scenario (i.e., the “all” portion of Verizon’s all or nothing approach) appears to constitute (ignoring other deficiencies with Verizon’s data) an undue economic burden.

The second characterization addressed is that Staff agrees that DSL TS cannot be provided in the Waiver Areas without substantial subsidies. Staff asserts that, presumably, Verizon’s statement reflects its position that revenue shortfalls per access line translate into subsidies. The problem with this representation is that, as with its characterization of Ms. Freetly’s testimony, it nowhere reflects the fact that Mr. Hanson’s testimony regarding revenue shortfalls per access line is based on the incremental cost and revenues associated with Verizon’s proposed ubiquitous DSL deployment scenario (i.e., the “all” portion of Verizon’s all or nothing approach) and that Mr. Hanson’s testimony was subject to other deficiencies with Verizon’s data. Staff asserts that these omissions are significant, particularly given Mr. Hanson’s testimony that, in fact, DSL TS can be provided in a substantial number of the waiver areas with revenues exceeding costs.

The third characterization is that Staff agrees that shareholders should not have to bear the costs of a mandated deployment of DSL TS. Staff asserts that while its position, as stated by Staff Witness Zolnierrek, is that DSL service as an aggregate should be self-supporting, “similar to, for example, what’s happening with the telephone side of the business for rate of return analysis” (Tr. at 381); Dr. Zolnierrek further explained:

So we are not asking the company necessarily to find (SIC) [fund DSL from] a set of customer[s] or shareholder profits. In our opinion this is conservative because it may be that the legislature intended for some of this to come from Verizon's shareholder profits, and the company could certainly do that if it had competitive concerns. But our recommendation doesn't necessarily call for that or require that.

Tr. at 382

Thus, according to Staff, the characterization attributes to Staff a position that was in fact not taken. Having a recommendation that “doesn’t necessarily call for or require” shareholders to fund DSL deployment is a far cry from Staff’s alleged agreement that “shareholders should not have to bear the costs” associated with DSL deployment, particularly given that part of Dr. Zolnierrek’s testimony was that “it may be that the legislature intended for some of this to come from Verizon’s shareholder profits . . . .”  
Tr. at 382.

The last characterization addressed by Staff is that it agrees that in assessing whether the deployment of DSL TS is in the public interest, the existence of advanced telecommunications services provided by an entity other than an ILEC is a relevant consideration. Staff asserts that while Verizon’s characterization here is not as significant as the problems with its other representations, Staff nonetheless needs to point out that its actual position, as stated by Staff Witness Zolnierrek’s is:

My opinion is that the General Assembly ordered the ILEC to do the providing unless a number of conditions were met that would qualify for a full or partial waiver. I think it would be reasonable to consider those factors in determining whether a full or partial waiver would be necessary. I think that is a consideration.  
Tr. at 366.

Thus, while Staff considers it reasonable to consider whether the existence of advanced telecommunications services provided by an entity other than an ILEC has an impact on establishment of the legislatively proscribed conditions for a waiver, Staff did not agree – as implied by Verizon’s representation – that the existence of alternative providers of advanced services is, in and of itself, a factor that would justify a waiver.

Staff finally responds to Verizon’s attempts to characterize the 17% penetration rate for DSL TS presented in its direct testimony as “unrealistic” and “illustrative” and Verizon’s attempts to rely on what it contends is the actual penetration rate for DSL TS deployments in Illinois that have been in service for three or more years. Staff asserts that this so-called “actual” penetration rate was not raised until surrebuttal testimony (preventing parties from offering responsive testimony), and even then was presented by Verizon for comparative purposes and without restating its revenue projections based on such penetration rate. Staff continues that, in general, Verizon spends an inordinate amount of time in its initial brief arguing that the penetration rates it submitted and relied upon for its waiver request should not be relied upon for one reason or another. Staff goes on to argue that Verizon’s assertion that there is a lack of demand for advanced services based on the number of intervenors in this case is nothing more than rank speculation and must be rejected.

Staff concludes that if Verizon's position is that it is entitled to a waiver based on a penetration rate and associated revenues other than the penetration rate and associated revenues that it submitted, then it was obligated to present them in this case. Similarly, if Verizon did not want its waiver request evaluated under an estimated 17% penetration rate, then it should not have incorporated such numbers into its analysis. The fact is that Verizon did incorporate such numbers into its analysis, and its apparent regret over that decision does not justify its current arguments.

Staff then responds to Verizon suggestion that its waiver should be granted because it will implement a Bonafide Request Process that customers can use to explore any possible way to provide advanced telecommunications services in targeted locations in an economically efficient manner. Staff responds that Verizon's commitment to provide a BFR Process to those customers located in Verizon's proposed waiver areas should be ignored because this commitment is in no way related to the statutory requirements of Section 13-517 and appears to achieve nothing other than the generation of additional expense that will presumably be passed on to these customers whether or not they actually obtain access to advanced services.

Staff next responds to Verizon's arguments relating to subsidies and its contention that Staff changed its position in the 11<sup>th</sup> hour to assert that supranormal profits from existing DSL TS deployments could subsidize deployments that otherwise could not stand on their own, while providing no basis for its position that the supposed "supranormal" profits are in any way relevant to Verizon's waiver request or that they even exist.

Staff first addresses Verizon's assertion that Staff provided no basis for its position by arguing that the position is factually wrong and substantively without merit. Staff states that it explicitly explained in testimony that its analysis and recommendation were tied to the applicable statutory waiver standards. Staff posits that Verizon's arguments demonstrate either a complete lack of understanding of Staff's position or an incredible mischaracterization of Staff's position because Staff explicitly acknowledged and addressed Verizon's concerns regarding subsidies and provided evidence that indicates that a waiver is not necessary because Verizon can deploy DSL in a significant number of exchanges without shortfalls at the exchange level.

Second, although not amounting to a substantive response, Verizon's attempt to cast Staff in the negative light of an alleged "11<sup>th</sup> hour" change in position is both inaccurate and unfair. As explained previously, Staff position is that the data presented in Verizon's direct testimony was wholly deficient and did not permit Staff to conduct required analyses. Staff argues that because of this it should have come as no surprise to Verizon that Staff was not able to present its full analysis until rebuttal after Staff received data from Verizon that was somewhat improved. Staff concludes that Verizon's general characterization of Staff's analysis of data not previously provided by Verizon as an 11<sup>th</sup> hour change is simply wrong.

Staff goes on to note the irony in Verizon attacking a revision by Staff witness Freetly that was generally favorable to the Company. Staff revisions to the cost and revenue estimates associated with Verizon's proposed ubiquitous DSL deployment (based on new information provided in Verizon's surrebuttal testimony) indicated a larger potential shortfall under this scenario than those previously analyzed by Ms. Freetly. Staff thought it fair to the Company and helpful to the Commission to submit an updated analysis using these new figures. Ms. Freetly's updated analysis indicated that the impact of the revised incremental cost and revenues associated with Verizon's proposed ubiquitous DSL deployment scenario appears to constitute (ignoring other deficiencies with Verizon's data) an undue economic burden. Verizon objects to Ms. Freetly's qualification of her updated assessment (which was favorable to the Company) based on the fact that Staff had never received cost and revenue numbers to account for Verizon's existing advanced services deployment. Staff's actions in this regard were neither unfair to the Company nor a true change in position. Rather, Staff appropriately explained and qualified its updated assessment.

Staff then addresses Verizon's argument is that "[a]dvanced telecommunications services should only be deployed where they can stand on their own" and that a waiver should be granted in all other cases. Staff indicates that it can understand why this might be Verizon's preferred business position but argues that the problem with Verizon's position is that its preferred position was not adopted by the legislature. Section 13-517(b) does not limit a carrier's obligation to those situations where offering or providing advanced services would be totally self supporting. As such, Verizon's position is nothing more than a not too subtle attempt to re-write Section 13-517 and, accordingly, must be rejected. The appropriate standards for a waiver are unduly economically burdensome, significant adverse economic impact, technically infeasible, and otherwise impractical in exchanges with low population density. Staff asserts that its analysis and position is fully consistent with these standards.

In terms of Verizon's argument that the Commission should rely on the marketplace to promote the deployment of advanced services, Staff responds that the flaw in Verizon's reasoning and, consequently, in its waiver request, is that the legislature has specifically rejected reliance on the marketplace by enacting Section 13-517. Staff goes on to assert that, rather than rely on the market to encourage the provisioning of advanced services to Illinois customers, the General Assembly has instead opted to create a statutory obligation on the part of incumbent local exchange carriers to make advanced services available to 80% of their customers by January 1, 2005. Staff asserts that if the market had been working effectively, the legislature would not have deemed it necessary to obligate the ILECs to make advanced services available to their customers by a specified date. To argue, as Verizon does, that reliance on the marketplace should be the controlling factor in determining the Commission's actions in this proceeding is tantamount to asking the Commission to ignore the statute it is obligated to enforce. This would lead to the absurd result that the Commission, as a creature of state law, would enforce state law with an eye to nullifying it and writing Section 13-517 out of the PUA.

Staff also responds to Verizon's assertions that deployment of a particular service would be voluntary if the company thought the service would be profitable. According to Staff, while that statement might comport with the actions of a company, Section 13-517 does not rely upon a company to deploy advanced services of its own accord; rather, it mandates a company to carry out that deployment and investment by a date certain. The only exception to this mandate requires the Commission to determine that a waiver is both necessary to avoid significant statutorily identified harms and consistent with the public interest, convenience and necessity. Section 13-517 does not permit a waiver to be granted based upon a company's own cost benefit analysis and internal business decisions. According to Staff, the internal business decisions of a company are irrelevant to the Commission's determination as to whether a waiver should be granted under Section 13-517, because the statute focuses on whether compliance with its requirements would be technically infeasible, impractical to implement in exchanges with low population density, unduly economically burdensome or would create a significant adverse economic impact on users of telecommunications services generally, not on whether the company would have made the same internal business decision as imposed by the statute. As a result, Verizon's arguments that Staff's position inappropriately delves into the realm of company funding and investment decisions are irrelevant to this proceeding because they are chiefly an attack on the statute. According to Staff, this proceeding is not the proper forum for an attack on Section 13-517; this is the forum for enforcement or implementation of that statute for so long as it remains effective.

Verizon argues throughout its brief that the PUA requires investment in advanced telecommunications services to be "prudent". Verizon points to a general policy section of the PUA, Section 13-103, to support its argument that the General Assembly, although encouraging the provision of advanced telecommunications services to a high percentage of end users in the state nevertheless recognized that the investment must be prudent.

Staff argues that various court decisions have concluded that prefatory language such as that contained in sections 13-102 and 13-103 is generally not regarded as being an operative part of statutory enactments because the function of the preamble of a statute is to supply reasons and explanations for the legislative enactments rather than conferring powers or determining rights. See *Illinois Independent Telephone Association v. Illinois Commerce Commission et al.* -- *GTE North Incorporated v. Illinois Commerce Commission et al., consolidated*, 183 Ill. App. 3d 220, 539 N.E.2d 717, 1988 Ill. App LEXIS 1892, 132 Ill Dec. 154 (1988 4<sup>th</sup> Dist.); 1A N. Singer, Sutherland on Statutory Construction § 20.03, at 81 (Sands 4th ed. 1985).

Further, where the legislature has desired to elevate the general policy goals of Section 13-103 to the level of specific statutory requirements or criteria, it has had no difficulty drafting language to evidence such intent within the language of the more specific statutory provision. In Section 13-301 of the PUA, the legislature established explicit requirements specifically intended "to ensure the attainment of such policies . . . ." 220 ILCS 5/13-301. Similarly, in Section 13-506.1 of the PUA, the legislature

expressly provided that the Commission must consider the “public policy goals declared in Section 13-103 . . . in determining the appropriateness of any alternative form of regulation . . . .” 220 ILCS 5/13-506.1 Staff notes that the legislature made no such pronouncements with respect to Section 13-517, and Verizon’s attempt to rewrite the waiver provisions of Section 13-517(b) must be rejected.

Staff next addresses Verizon's arguments relating to its assertions that that the vast majority of Verizon’s exchanges serve rural areas characterized by low customer density attributes; that the costs that Verizon will incur to deploy DSL TS in its rural areas will be significantly higher than the costs to a more urban company, like Ameritech; and that based on these premises the Commission should grant Verizon’s requested waiver on the grounds that it is impractical to require deployment of DSL TS facilities.

Staff, based upon the apparent assumption that this request is predicated upon Section 13-517(b)(1)(D) of the Act, notes that this section provides that the Commission is authorized to grant a waiver if full compliance with Section 13-517 would otherwise be impractical in exchanges with low population density. Based upon this assumption, Staff argues that Verizon’s argument might have had some validity if Verizon had produced evidence in this proceeding that identified which of the exchanges in its proposed Waiver Areas constituted exchanges with low population density. Staff asserts that Verizon failed, however, to identify any exchanges that have low population density, to provide evidence supporting that identification, and to provide exchange-specific reasons for finding compliance otherwise impractical. Rather, the only evidence produced by Verizon in this record is its aggregate cost and revenue data.

Because according to Staff, the “otherwise impractical” waiver condition is limited to exchange based waiver requests, the statute clearly requires that the Commission make its determination with respect to “exchanges with low population density.” Consequently, it is not enough for Verizon to assert that a vast majority of its exchanges serve rural areas, it must identify them in order to satisfy the statutory standard and provide evidence supporting its identification and the costs and revenues associated with such exchanges. Here, Staff notes, the only evidence regarding the population attributes of exchanges that should be deemed to meet the statutory requirement was brought into the record by Staff’s cross-examination. In that context, Verizon witness White testified that he would consider exchanges with less than 1,000 access lines to have low population densities. It is not clear if this is Verizon’s position (as there is no indication of same in its brief). Staff further questions whether this testimony establishes that such exchanges are indeed exchanges with low population density.

Thus, in the end, the only evidence in the record that even remotely bears on this exchange specific waiver request was provided by Staff and is disputed by Verizon. (Staff Late Filed Exhibits 2, 4 and 6) Therefore, Verizon has not made its case for a waiver based on the impracticality of compliance with Section 13-517 in exchanges with low population density, and its assertions should be given no weight.

## **G. AG's Replies**

The AG begins by noting that Verizon's position is essentially that it alone should determine when, where, and to what extent it will deploy advanced services in Illinois. For example, on page 6, after commenting on the People's testimony in the case, Verizon asserts:

Moreover, the fact that the AG and Staff are even attempting to dictate to Verizon what services can be profitable is economically improper and poor public policy. The only prudent and legal course for the Commission is to let the marketplace and new technologies drive appropriate investment decisions.

Staff further noted that, at page 54, Verizon emphasized this concept, stating: again, "the premise that the AG and Staff can better determine what services are profitable to deploy simply is ludicrous on its face." In describing its bona fide request process, whereby customers pay Verizon a portion of the costs to deploy DSL in a given area, Verizon states:

This process allows Verizon and the interest group to engage in analyses, which could lead to rational DSL-TS deployment in high-cost market areas. In short, this process will accommodate what the market actually desires, not what various groups believe the public wants, and will ensure there is no undue economic burden on Verizon and its customers.

Verizon Initial Brief at 9.

Verizon witness Slagle also made this point, when he said on cross-examination:

A. I think we're seeking a waiver for us to make a choice on what COs we want to deploy.

Q. So you -- and if I'm mischaracterizing, correct me, but if I understood your answer, you're seeking a full waiver, and then Verizon would decide after getting a waiver where it would deploy.

A. That would be a better way to put it, yes.

Tr. 122.

According to the AG, Verizon's express goal in this docket appears to be to retain the unfettered discretion to deploy advanced services as it chooses, irrespective of the legislative determination that such services should be broadly available to promote the public interest. The AG posits that, had Verizon accepted the General Assembly's determination that deployment of advanced services is required and is in the public interest, it would have tailored its filings more closely to the legal requirements of section 13-517, and avoided the information quagmire it created by trying to nullify its section 13-517 obligations through unrealistic assumptions. The AG argues that a fair

determination of whether Verizon is entitled to a waiver requires both fair and honest data and the commitment to follow the mandate of section 13-517 to make advanced services available to at least 80% of Verizon's customers to the extent economically possible while a careful examination of Verizon's case demonstrates that neither of these factors were present and that a decision in its favor would be erroneous.

In response to Verizon's assertion that the Commission cannot consider deployment of DSL in determining whether Verizon complies with section 13-517 because DSL is beyond the Commission's jurisdiction and because Verizon does not offer DSL directly to the public, the AG argues that Verizon has attempted to set up a strawman by first basing its waiver application on its inability to deploy DSL but then claiming that the Commission has no authority to address DSL deployment. The AG notes that Section 13-517 directs the ubiquitous provision of advanced services. It does not specify what type of service or technology should be used. Verizon's decision to present DSL deployment as the mass market product best suited to economically and ubiquitously provide high speed service supports the notion that DSL can reach a large portion of Verizon's customers at a relatively reasonable price. According to the AG, it is disingenuous for Verizon to argue that it is entitled to a waiver because of the high cost of DSL deployment, but then argue that the Commission lacks the authority to review DSL deployment in the context of a section 13-517 waiver and curious that Verizon claims that DSL TS is not directed to the public and that it is not possible for the Commission to direct it to offer this service to the public to satisfy its 13-517 responsibilities.

The AG argues that if Verizon did not believe that DSL TS was capable of complying with section 13-517, it may have been inappropriate for Verizon to use the cost and revenue profile of DSL TS to justify its waiver request. The AG posits that this is the likely result of an apparent collision between realistic data and expedient argument. The AG goes on to note that Verizon has adopted this position despite the fact that DSL has been offered by Verizon affiliates and other ISPs in some of Verizon's territory; that consumers have purchased that service; and that DSL provides services at speeds in excess of 200 kps. The AG concludes that this argument should be rejected as lacking credibility and conflicting with Verizon's own testimony, exhibits and data.

The AG continues that Verizon's arguments present a classic Catch-22 for Illinois consumers. Verizon maintains that the Commission only has jurisdiction over services such as DS-1, Frame Relay, ATM and HCD which are priced too high for the average residential and small business consumer and which are not in fact used by those consumers. Verizon then argues that although DSL service can economically serve residential and small business consumers and has been offered ubiquitously in various areas throughout the state and the country, the Commission lacks jurisdiction to consider it as an appropriate advanced service under Section 13-517. According to the AG, this would effectively put DSL beyond the reach of most of Verizon's Illinois consumers, an absurd result that should be rejected.

The AG next turns to Verizon's claims that Section 13-517 has to be read to somehow incorporate a prudence standard it believes is found in Section 13-103 of the Public Utilities Act, which, it asserts, operates as an additional waiver criterion to be read together with the criteria listed in 13-517(b). The AG responds that Verizon's argument rests on the faulty premise that section 13-103 contains substantive requirements that somehow supplement or even supersede the express terms of section 13-517, whereas it is well established that prefatory or policy pronouncements in a statute do not impose substantive obligations.

The AG next addresses the 17% penetration rate issues. The People argue that, regardless of the appropriate penetration rate, the fact remains that the People and Staff responded to Verizon's testimony that purported to show that even at a 17% take rate, further DSL deployment was uneconomical. The AG notes that Verizon, in seeking to revise its evidence, argued in its Supplemental Surrebuttal Testimony that the 17% take rate it used throughout its testimony and exhibits was unrealistic, while relying through all phases of its case upon Mr. Trimble's Table 7, which showed an overall 18% take rate for business and residential high speed access. The AG continues by noting that table was based on a Southern Illinois University study, which concluded that 18% of business and residential customers would be willing to subscribe to high speed internet access at a price of \$50.00 per month. Mr. Trimble pointed out that this 18% actually translated into a higher penetration rate when only customers with computers were considered. From this the AG infers that as more customers obtain computers, the overall penetration rate would increase and concludes that Verizon's own evidence amply supports the use of a 17% take rate.

The AG next addresses Verizon's suggestion that the penetration rate is unrealistic when used by the People or Staff because there are alternatives to DSL that would reduce Verizon's market share should it deploy DSL. The AG responds by first noting that Verizon never offered any evidence on the extent of available alternatives in the waiver area or in its service territory as a whole other than the most general statements, usually in the form of questions from counsel, about high speed internet alternatives. The AG concludes that it was not the People's responsibility to provide data to support Verizon's waiver claim where Verizon has failed to do so.

The AG next addresses Verizon's assertions relating to interservice subsidies and its reliance upon Commission Rule 791 as an example of a clear and unambiguous definition as to whether a service is subsidized. The AG notes that this rule states that a service is not subsidized if the total revenue resulting from the service equals the long-run service incremental cost of providing that service. The AG notes that while Verizon fairly asserts that incremental costs should be considered, it incorrectly maintains that only incremental revenues not total revenues be considered. The AG goes on to notes that total revenues from DSL service are not part of the record, so it is impossible to apply the Part 791.90 test to determine whether continued deployment of DSL would in fact violate the Commission's subsidy rules. The AG concludes that, because this data is solely within the control of Verizon, its failure to provide it, regardless of whether it was requested by any other party, raises the presumption that the evidence would be

adverse to Verizon. Saunders v. Illinois Dept. of Public Aid, 198 Ill.App.3d 1076, 556 N.E.2d 736 (1st Dist.1990)(and cases cited above).

The AG concludes its discussion of subsidy issues by noting that Verizon did not argue that the central office deployment proposal of People's witness William Dunkel raised subsidy issues. Further, Mr. Dunkel's proprietary schedule WD-1 demonstrates that the revenues from central office DSL deployment far exceed the associated costs at full deployment, eliminating any subsidy objection. Mr. Dunkel's analysis, which considers incremental costs and incremental revenues only, demonstrates that the People's recommendation that service be deployed to the 69.9% of customers who can be served from their central office does not raise subsidy issues. In addition, by considering revenues over the life of the investment, Mr. Dunkel showed that revenues from central office DSL deployment more than covered costs in the long term.

#### **IV. COMMISSION ANALYSIS AND CONCLUSION**

The Commission has reviewed the evidence and arguments of the parties and finds that the following issues are presented for determination:

- 1) Whether the Commission has the authority to certify that Verizon is in compliance with Section 13-517 and, in the event that it has such authority, it should so certify.
- 2) Whether Verizon should be granted a waiver from the requirements of Section 13-517.
- 3) Whether any waiver granted under Section 13-517 should be limited in scope or duration.

We turn now to a discussion of those issues.

##### **A. Jurisdiction**

The Commission concludes that it has jurisdiction to determine whether Verizon's current intrastate advanced telecommunications services offerings meet the requirements of Section 13-517 of the Act and, if so, certify Verizon as in compliance with Section 13-517 of the Act. Contrary to Staff's characterization, Verizon has not requested a declaratory ruling from the Commission, and the Commission's grant of the requested certification would not constitute a declaratory ruling subject to 83 Ill. Admin. Code 200.220. The question is not whether a case and controversy is presented, but rather is simply a question of timing, as Staff readily admits that the Commission would have jurisdiction to make the requested determination through an enforcement proceeding initiated after January 1, 2005. As such, it is the Commission's opinion that there is no legal prohibition to the Commission's resolution of the presented controversy at this time based on the full and complete record adduced in this proceeding.

Moreover, the Commission finds that making such a determination at this time is not only legally appropriate but imperative from a policy perspective. Should Verizon's current intrastate advanced telecommunications services offerings not satisfy the requirements of Section 13-517 of the Act, Verizon would potentially need to engage in significant planning and investment to deploy services that would satisfy the requirements of the Act. Verizon would need to begin such activities now, significantly in advance of January 1, 2005, in order to complete the deployments by January 1, 2005. On the other hand, should Verizon's current intrastate advanced telecommunications services offerings satisfy the requirements of Section 13-517 of the Act, the significant planning and investment that potentially would be necessary for Verizon to deploy another advanced telecommunications service could be avoided, but only if Verizon knows, at this time, that Section 13-517 does not require Verizon to undertake such activity. Thus, the Commission finds that it would be contrary to the public interest to withhold the Commission's determination on the presented controversy until sometime after January 1, 2005.

## **B. Waiver**

As the discussion of the parties' positions amply demonstrates, the issues before the Commission in terms of Verizon's waiver request are many and varied. This results, in large part, from the fact that the statute under consideration is long on matters of degree and short on matters of principle in that it defines the various waiver conditions in terms of "significant" adverse economic impacts and "undue" economic burdens, without establishing any parameters or other metrics that are to bear upon the decision. Accordingly, the Commission concludes that it has been granted a clean slate upon which to write. To that end, a number of observations may be made.

The Commission finds no merit in Verizon's arguments relating to the Commission's authority to "mandate" the delivery of advanced services through the company's admittedly interstate (and FCC controlled) DSL ST service. The Commission's decision herein determines only whether Verizon should be excused from providing advanced services to some of its customers under the incremental scenario it has chosen to proffer, increased coverage of DSL TS. If Verizon believes another avenue is open to it and that avenue would result in the adverse consequences contemplated by the waiver criteria of Section 13-517, it is free to petition the Commission based upon those facts. The only requirement of Section 13-517, is that Verizon offer or provide advanced services to 80% its customers by January 1, 2005.

The Commission also agrees with Staff that, in seeking the relief sought herein, it was incumbent upon the petitioner to adduce evidence and prove that the manner in which it proposes to satisfy the legislative imperative is the least cost method.

With those observations in mind, the Commission now turns to the evidence adduced by Verizon in support of its waiver case. While all parties agreed that an incremental approach was desired, it was simply not always apparent exactly what costs and revenues were included in the Company's various iterations of its case. The

Commission recognizes that those iterations likely included some costs that should not have been included and failed to recognize some revenues that should have been. This does not change the fact, however that the overwhelming evidence establishes that the costs of deploying DSL TS in the Waiver Areas would significantly exceed the anticipated revenues.

The Commission concludes that Verizon should receive a waiver of the requirements of Section 13-517 with respect to the areas where it currently does not deploy DSL TS. Though the record is not perfect, we recognize that this docket is somewhat unique in that this is a case of first impression and our relevant administrative rules (Code Part 733) were not yet in effect. In addition, much of the evidence on which the Commission relies for granting Verizon a waiver is undisputed or its shortcomings have been addressed. We also find it significant that both Staff and AG suggested that a waiver, albeit a limited waiver, might be appropriate.

The substantial weight of the evidence establishes that the cost of deploying DSL TS in the Waiver Areas would significantly exceed Verizon's reasonably expected revenues by a very substantial amount and would cause Verizon to experience a large short-fall in revenues. As such, we find that mandating Verizon's deployment of DSL TS in the Waiver Areas would constitute a requirement that is unduly economically burdensome.

Section 13-517(b) requires the Commission to grant a waiver from the Section's requirements when necessary to avoid imposing a requirement that is unduly economically burdensome. 220 ILCS 5/13-517(b) (expressly providing that the Commission "shall" grant waivers under such circumstances). In this case, the evidence establishes that Verizon's costs to deploy DSL TS in the Waiver Areas would far exceed any recovery Verizon would realistically expect to receive.

The evidence is also substantial that there would likely be very low demand for DSL TS in the Waiver Areas. We find compelling the recent survey performed by the Office of Economic and Regional Development, Southern Illinois University, which concluded that only 2% of the respondents that did not currently have high-speed access would be willing to pay \$50 per month to obtain such access. (See, Verizon Ex. 7.0, Trimble Sur., p. 22). The results of this study were not disputed by any party. Verizon's actual penetration rates in other areas in Illinois where Verizon has deployed DSL TS also confirm the validity of the study results. (*Id.*)

Verizon presented an estimate of the cost to deploy DSL TS in the Waiver Areas. (See, *Id.*, pp. 14-15). Verizon also introduced a conservative estimate of the amount of revenues that would be needed to recover costs, and the amount of revenues that Verizon could, optimistically, anticipate receiving. (See, *Id.*, pp. 14-16).

Even using what the evidence establishes is an aggressive, and highly unlikely, penetration rate of 17%, Verizon's cost studies demonstrated that their anticipated revenues would likely under recover Verizon's costs of deployment by a very substantial

amount. (See, *Id.*, p. 17). While Verizon's purpose for utilizing the 17% take rate (i.e., developing a "best case" scenario by demonstrating that even at an inflated take rate, deploying DSL to 80% of customers was uneconomic) is understandable, it has led to some confusion. Staff and the AG incorporated the 17% figure in their analyses to demonstrate the full flow through of the assumption. This unfortunately led to Staff and AG's analyses also being infected by this inaccurate information. The Commission has no faith in any of the conclusions based upon the 17% assumption and can not endorse a recommendation infected with this flawed assumption.

We find most compelling Verizon's analysis that utilizes the actual penetration rates experienced by Verizon in other areas in Illinois where DSL TS is deployed. As previously mentioned, incorporating the inflated 17% take rate tainted the analyses of Staff and AG. However, by using the actual take rate instead of the number that Verizon deliberately increased for another purpose, the Company demonstrated that an appropriate analysis results in significant revenue shortfalls throughout the duration of the study period. It is the judgment of the Commission that this is the most accurate analysis of the economic impact of requiring Verizon to comply with Section 13-517(a). This analysis not only takes into consideration the least cost principles described above, but utilizes an appropriate take rate in its calculation of revenues. Therefore, in accordance with Sections 13-517(b)(1)(B) and 13-517(b)(1)(D), the Commission concludes that a full waiver of Section 13-517(a) with respect to the Waiver Areas is necessary in order to avoid imposing an undue economic burden on Verizon and to avoid imposing a requirement that is otherwise impractical to implement in exchanges with low population density.

Intuitively, it seems that there are likely some areas of the Verizon service territory where deploying DSL would be prohibitively expensive in terms of the potential return on and return of investment, and the evidence supports that conclusion. Indeed, Staff concedes that its implied ROE analysis shows that the impact of complying with Section 13-517(a) would appear to constitute an undue economic burden and would not provide Verizon with a fair opportunity to earn a reasonable rate of return over the long-term.

Additionally, the Commission is cognizant of the rapidly expanding impact that technology has had and likely will continue to have on internet access. The record demonstrates that within five years technology may advance to the point that high speed internet access in Verizon's service territory through copper is a moot point or that cost issues are no longer relevant. Staff witness Liu made this point clear in her testimony. (Staff Ex. 1.0, Liu Dir., pp. 9-10; Tr. at 341).

Finally, we note that Verizon has committed to implementing a bona fide request ("BFR") process should a waiver be granted. Through the BFR process, customers in the Waiver Areas will be able to explore possible ways of provisioning advanced telecommunications services in an economically efficient manner. (See, Verizon Ex. 2.0, Trimble Dir., pp. 23-24). While a BFR process is not a requirement for a waiver under Section 13-517 of the Act and, consequently, is not something that we are approving in

this Order, we find Verizon's commitment to implement the BFR process demonstrates a willingness to work with parties in the Waiver Areas to provide advanced services, DSL TS or otherwise, where deployment is a financially viable option.

### **C. Waiver - Scope and Duration**

In addition to the nature of the waiver, the parties have proposed various time frames for the waiver to remain in effect, ranging from one to three years to five years. Realizing that any time frame selected will be somewhat arbitrary, the Commission concludes that the waiver granted shall extend the time for compliance with the 80% requirement for a period of three years beyond that contemplated by the act. Limiting the period for compliance to three years may allow technology to advance to the point that high-speed internet access in Verizon's service territories is less costly and more economic for the Company to deploy. In addition, a three-year waiver will allow the parties to gain additional, credible evidence concerning costs and revenues and penetration rates, in the event Verizon again seeks relief.

## **V. FINDINGS AND ORDERING PARAGRAPHS**

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) Verizon North Inc. and Verizon South, Inc., are telecommunications carriers as defined by the Illinois Public Utilities Act;
- (2) the Commission has jurisdiction over the parties and the subject matter of this proceeding pursuant to the Illinois Public Utilities Act;
- (3) the recitals of fact and conclusions of law set forth in the prefatory portion of this order are hereby adopted as the findings of fact and conclusions of law of the Illinois Commerce Commission.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that:

- A. Verizon North, Inc. and Verizon South, Inc. are hereby granted a waiver of the requirements of 220 ILCS 13-517 for those exchanges where it currently does not offer or provide advanced services (as specified herein);
- B. The waiver granted herein shall expire January 1, 2008.

IT IS FURTHER ORDERED that any materials submitted in this proceeding for which proprietary treatment was requested shall be accorded proprietary treatment.

IT IS FURTHER ORDERED that any petitions, objections or motions made in this proceeding and not otherwise specifically disposed of herein are hereby disposed of in a manner consistent with the conclusions contained herein.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this 24th day of June, 2003.

(SIGNED) EDWARD C. HURLEY

Chairman